



## **FISCAL YEAR 2002 ANNUAL REPORT**

Delivering  
Quality Water  
to a Desert Community

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*City of Tucson  
Water Department*

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## **TUCSON WATER**

provides water service to  
approximately 680,000 people  
(about 85% of the greater Tucson  
metropolitan area's total population)  
within a 300 square-mile area.

Last year, Tucson Water delivered  
36 billion gallons of potable water.

Additionally, Tucson Water  
delivered 3.7 billion gallons of reclaimed  
water for turf irrigation.

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Council, City of Tucson

José J. Ibarra  
Ward 1

Carol W. West  
Ward 2

Kathleen Dunbar  
Ward 3

Shirley C. Scott  
Ward 4

Steve Leal  
Ward 5

Fred Ronstadt  
Ward 6

James R. Keene, Jr.  
City Manager

Letter from  
Robert E. Walkup  
Mayor



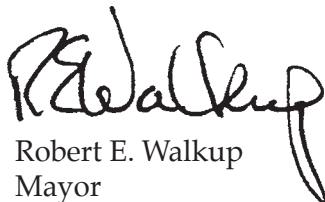
2002 was a year of successes for Tucson Water, its customers, and the community as a whole.

The challenges of meeting customer water demands during one of the hottest and driest summers on record were met with the expanded utilization of our newest renewable resource, recharged and recovered Colorado River water from our Clearwater Renewable Resource Facility. Despite record demand, Tucson Water was able to shut down additional wells in the central city and actually measure significant gains in the groundwater level of the central well field.

Our reclaimed water customer base increased to over 600 customers last year, including five new connections to schools, and an agreement to connect nine more schools in the next few years. Continued expansion of our nationally recognized reclaimed water system has further enhanced our water use efficiency and groundwater savings.

Community cooperation is fundamental to the ongoing success of any enterprise. The diligent water conservation efforts of our 680,000 customers helped control water use and kept demand from rising even higher last summer. Tucson Water played a role in battling the Bullock Fire, which ravaged the Catalina Mountains in May, by supplying about one million gallons of water to the effort. We also were able to provide millions of gallons of water to several small local water companies who needed temporary help in meeting their own customers' demands last summer.

As you will read in the next few pages of this annual report, Tucson Water's first goal is to ensure the delivery of safe drinking water to its customers. In Fiscal Year 2002, more water than ever before was delivered. In Fiscal Year 2003 and beyond, we look forward to continued success with further replenishment of the central well field, increased water use efficiency, and new endeavors that allow Tucson Water, their customers, and the community to work together in resolving community issues and maintaining a sustainable water supply for Tucson.

  
Robert E. Walkup  
Mayor



Marie S. Pearthree, P.E.  
Deputy Director

Bruce Johnson  
Assistant Director

Jim Broderick  
Business Services

Ted Sroka  
Operations & Maintenance

Steve Pageau  
Planning & Engineering

Joe Babcock  
Planning Administrator

Jeff Biggs  
Water Quality Management

Dennis Rule  
Public Policy

David Cormier  
Finance Officer

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Citizens' Water  
Advisory Committee

James J. Riley, Chair  
Ronald Wong, Vice-Chair

Nathan Buras

John Carhuff

Arthur Flagg

Chuck Freitas

Keith Gentzler

Irene Ogata

Stephen R. Popelka

Sonny Rickles

David Smutzer

Jennifer Sprung

Tarke Sweet

David Turner

Vernon Watwood



Letter from  
David V. Modeer  
Director

During the past year, Tucson Water has continued our program of self-improvement, setting strategic goals and implementing programs to improve efficiencies. Most recently, emphasis has been placed on our Reengineering efforts and the implementation of our Maintenance Management Program (MMP). These programs are the result of an intense employee driven process requiring many months of planning.

MMP is designed to substantially improve the manner in which operations and maintenance are performed by Tucson Water. The program involves work simplification, reorganization, and broad-banding of job skills. We anticipate that many benefits will be derived from developing multi-skilled worker positions. By training staff to perform most maintenance functions, and by reducing the number of specialist positions, the work can be done more efficiently. The increased efficiency of maintenance work will mean that we can accommodate more customers in the future, and provide more service at a lower unit cost. The Program is expected to generate annual saving of approximately \$1.3 million beginning in Fiscal Year 2005.

The MMP Pilot, which was recently endorsed by Mayor and Council, will soon be underway. The Pilot is a one-year test of reengineered approaches to the Utility's operations and maintenance work. Upon successful completion, it will be applied to over 4,000 miles of water mains, over 200 active wells, 125 boosters, 15,000 fire hydrants, and 62,000 valves.

Our commitment to improving internal work processes, and exceeding customer service expectations, has been acknowledged by the Association of Metropolitan Water Agencies. Tucson Water was the recipient of the distinguished *Gold Award*, recognizing the Utility for competitiveness and meeting the ever-expanding array of customer service needs and expectations.

In the future, we will continue to strive for operational efficiencies that will ensure the delivery of affordable, high quality water to the community for years to come.

A handwritten signature in black ink, appearing to read "David V. Modeer". The signature is stylized with a large, sweeping initial "D".

David Modeer  
Director

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## **2002 ANNUAL REPORT**



Delivering  
Quality Water  
to a Desert Community

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## DELIVERING QUALITY WATER TO A DESERT COMMUNITY

### Introduction

Water consumers nationwide are increasingly concerned with the quality of their drinking water. Tucson Water is committed to educating and informing customers about the quality of the water we deliver by making water quality information accessible in a timely and meaningful manner. Working with a number of other community agencies, we continue to improve our on-going Water Quality Information programs. By developing new educational materials, hosting workshops, and providing information through print and electronic media, we are offering additional assurance to the community that our drinking water supply is safe. The information we provide assures our customers that we are working to meet their needs for high quality, reliable, and affordable water.

### Ensuring Safe Water

Our primary goal is to protect the health and safety of our customers. The Arizona Department of Environmental Quality (ADEQ) enforces rigid drinking water regulations for Tucson Water and other public water systems in the State of Arizona. Additionally, a number of federal regulations impact water systems. The federal *Safe Drinking Water Act (SDWA)*, passed

in 1974 and updated in 1996, provides the basis for ensuring the safety and quality of drinking water supplies throughout the nation.

### Regulated Compliance Monitoring

The *SDWA* directs the United States Environmental Protection Agency (EPA) to establish standards and requirements that protect customers from all known harmful contaminants in drinking water. More specifically, the EPA sets a National Primary Drinking Water Regulation (NPDWR) for contaminants:

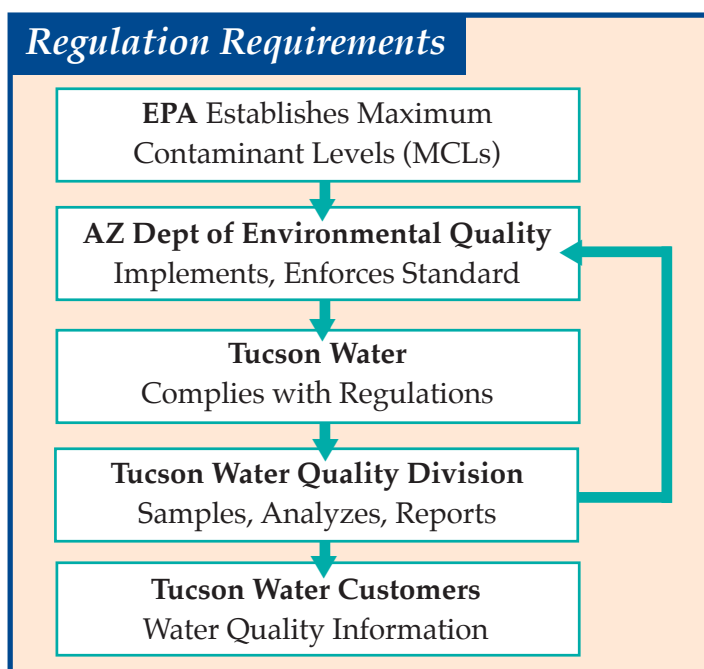
- ◆ that are known to occur in drinking water or reasonably likely to occur
- ◆ that may have an adverse effect on human health
- ◆ whose risk can be meaningfully reduced through regulation

Currently, maximum contaminant levels (MCL's) have been set for more than 80 contaminants. The states accept primary responsibility for enforcing the federal requirements and engaging in compliance monitoring for contaminants.

Our Water Quality Management Division maintains a full service environmental laboratory that is licensed by the State of Arizona. The lab is staffed with 14 degreed professionals in Chemistry and Microbiology. Staff is organized into five specific work units: inorganic analysis, organic analysis, microbiology, quality assurance, and client services. On average, over 4,000 drinking water compliance samples are processed annually.

State-of-the-art analytical equipment is employed and the data is managed and tracked with the aid of a Laboratory Information Management System (LIMS). The laboratory provides analytical services in support of Tucson Water's regulatory monitoring programs.

Our Water Quality Laboratory tests an average of 900 samples per month, taken at monitoring points throughout our distribution system. Many of those samples are not related to compliance



## DELIVERING QUALITY WATER TO A DESERT COMMUNITY

with the SDWA, but are for informational purposes. Compliance results are reported monthly to the State of Arizona, who then determines our compliance with the rules of the Safe Drinking Water Act.

### ***Additional Discretionary Monitoring***

In addition to the required compliance monitoring, we also engage in discretionary monitoring to determine levels of many unregulated characteristics of the water we deliver. We monitor the amount of chlorine in the water, as well as the levels of several minerals including calcium, magnesium, nitrates, and sulfates. Water samples are also tested for hardness, pH, alkalinity, and total dissolved solids. This data enables us to detect variances in water quality at specific points in our distribution system and provide detailed water quality information to our customers.

### ***Compliance Reporting***

Drinking water rules require us to report the results of our compliance monitoring program in an annual water quality report, also known as the Consumer Confidence Report. These reports must follow well-defined criteria, mandating utilities to report monitoring results in a uniform and straightforward manner. Our online archive of annual water quality reports can be accessed at [www.cityoftucson.org/water/water\\_quality/annual\\_wq\\_reports/annual\\_wq\\_reports.htm](http://www.cityoftucson.org/water/water_quality/annual_wq_reports/annual_wq_reports.htm).

The EPA continues to update regulations based on the most current research on contaminants. New regulations are presently being developed involving groundwater, surface water, distribution systems, disinfectants, disinfection by-products, radon, and other substances.

### ***Customer Outreach Initiative***

Our heightened sensitivity to providing reliable and readily available water quality information stemmed from the need to restore our customers' confidence in our product. Shortly after we began delivery of Colorado River water, also referred to as Central Arizona Project (CAP) water, to approximately half of our customers in

### ***Who Tests The Testers?***

Our Water Quality Laboratory is tested on a quarterly basis by the Arizona Department of Health Services (ADHS). The tests include studies of the laboratory's ability to accurately measure the quality of the water supply and detect water pollution. These "double-blind" tests confirm whether stringent laboratory standards are maintained throughout the year.

1994, many customers in the older sections of the City encountered problems with corrosiveness, color, poor taste and an unpleasant smell. Discolored water, leaks, and breaks resulted in numerous complaints. Due to the magnitude and severity of the problems, we halted delivery of CAP water in September 1994. In 1995, the public voted to ban direct delivery of CAP water in Tucson unless certain water quality conditions were met.

### ***Sampling Statistics***

- ◆ Manpower: 5 samplers
- ◆ Average annual sampling cost: \$250,000
- ◆ Average analytical costs: \$400,000
- ◆ Number of results reported in 2001: 10,133

We were forced to develop an alternative method of using the river water to supplement dwindling groundwater supplies. The Clearwater Renewable Resource Facility (CRRF) Project, where we recharge Colorado River water through constructed basins near the CAP canal and recover a blend of recharged water and native groundwater, was selected as the best use of our renewable water source.

In order to successfully introduce the concept and, ultimately, the water from the Clearwater blended water project, we increased public information and education about water quality in general. In 1997, we developed a Water Quality Information Program dubbed "At the Tap" to educate our customers on the quality of the groundwater we deliver.

## DELIVERING QUALITY WATER TO A DESERT COMMUNITY

### What is TDS?

Total Dissolved Solids (TDS) is a measurement of the mineral content in water. Mineral content can often affect the taste of the water; many people can detect a salty taste when TDS is above 500 parts per million. Although there are no health-based water quality standards for TDS in water, high TDS levels are also responsible for water spotting on dishes and plumbing fixtures and for the white mineral buildup sometimes seen on water faucets and swamp coolers.

To make the information more useful to customers, we first set out to determine which water characteristics were of most interest to the community. Through a series of bill inserts, focus groups, and a prominent newspaper ad with a tear-off response card, we polled our customer base for their water quality information preferences. Our Water Quality Laboratory was already conducting the required monthly monitoring of the water distribution system for contaminants. By combining this routine testing

with specific tests for parameters of interest to our customers, we were able to develop an on-going database of groundwater quality information.

To simplify the information, and because groundwater quality in Tucson varies significantly across our service area, we divided our distribution system into separate Water Quality Zones. Each zone was defined based on water pressure, elevation, operational issues, and service area boundaries. Information was presented to customers as a range and average for each water quality zone, thus providing a more accurate representation of the water quality in an area surrounding their property.

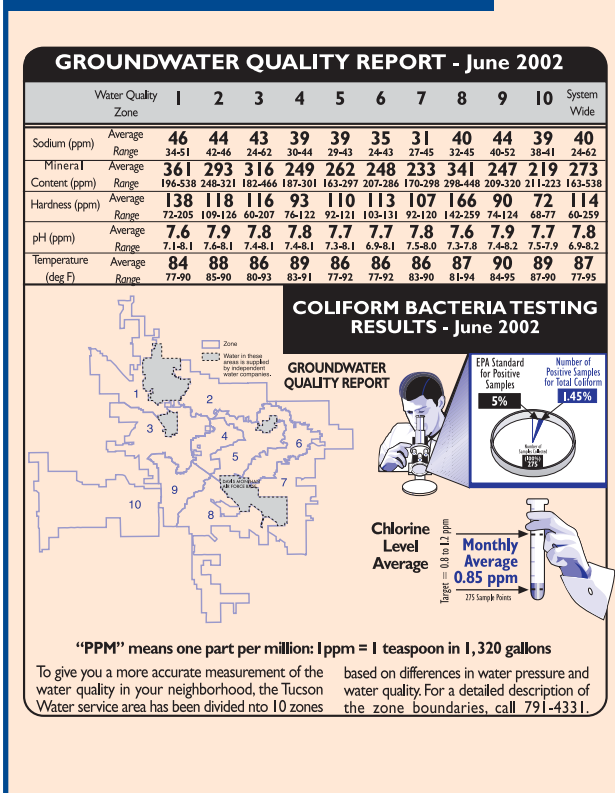
We initially presented the information to customers as a water quality graphic that ran on a monthly basis in Tucson's largest daily newspaper. After about a year, we began including the graphic in monthly water bill inserts, a practice we continue today.

### The EMPACT Program

Although customers and community leaders recognized our "At the Tap" program as a success, one limitation was the timeliness of information provided: the data was six weeks old by the time the results for 250 monitoring samples were obtained and published. It was clear that if our Water Quality Information Program was to reach its highest potential, a new and more technologically driven approach allowing for a more timely publication of information would be required.

The Environmental Monitoring for Public Access and Community Tracking (EMPACT) program was developed by the USEPA in 1996 to help communities collect, manage, and present timely, accurate, and understandable environmental information to their residents. In researching the two-year grant program, it was clear that the EMPACT goals closely matched those of Tucson Water. We collaborated with a number of community partners on a grant application and were awarded a \$400,000 grant in January, 2001.

### Monthly Customer Updates



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## DELIVERING QUALITY WATER TO A DESERT COMMUNITY

The grant funds allowed us to install 22 online water quality monitoring stations that continuously measure selected substances and automatically compile and upload this information to our web site on a daily basis. The parameters that we continuously monitor, limited by available technology, are chlorine, pH, conductivity (from which total dissolved solids can be calculated), and temperature. In addition to the automatically uploaded water quality information, the expanded water quality web site includes information on other substances and characteristics that were determined to be important to our customers, based on their responses to a new Water Quality Survey. To our knowledge, we are the only utility in the nation providing this type of timely access to drinking water quality data.

We developed a new, map-based interface for the Tucson Water water quality website, providing viewers with a number of intuitive tools to access water quality information. By basing the information display on the Water Quality Zone base map already in use, our customers were not required to learn a new conceptual system for obtaining water quality information. Unlike the printed version of the Water Quality Zone map, the new system Zone map is scalable and our customers can access recent water quality information compiled by wellfield, by Water Quality Zone, or by accessing information directly from more than 400 wells, points of entry, and distribution system sampling points.

Our EMPACT web site went live in May 2001, timed to coincide with our delivery of the blended water from the Clearwater facility. We promoted the new EMPACT web site feature through water bills, flyers and newsletters, public service announcements, and electronic and print media.

Among the most beneficial aspects to providing water quality information in this format is that not only do customers have access to meaningful information, they are introduced to the complexity and completeness of our water quality monitoring efforts. As a result of the EMPACT

### *Tucson Water's Partners in EMPACT:*

- ◆ Arizona Department of Environmental Quality
- ◆ Tucson Unified School District
- ◆ University of Arizona
- ◆ Pima County
- ◆ Tucson Hispanic Chamber of Commerce
- ◆ Other City of Tucson Departments

publicity, we have been contacted by customers who expressed their surprise at how often and how extensively we monitor their drinking water.

Although publishing water quality information on the utility web site is the primary goal of our EMPACT project, Tucson Water's community partners support the program by providing additional conduits for the flow of water quality information, both to the general public and to the constituents served by each agency. In upcoming months, Tucson Water and our community partners will be evaluating the EMPACT project using customer surveys and a review of user reactions to guide our efforts to make the website more customer friendly and easier to navigate. In addition, we will determine if the overall goals of the EMPACT program have been met: whether our customers are more aware of the availability of this water quality information than prior to the project start-up, and whether they are more confident about the quality of the water we deliver.

By continuing to proactively educate and inform our customers about the quality of the water we deliver, and making information about water quality easily accessible, Tucson Water is forging a stronger trust in our water supply and in our ability to deliver it.



## 2002 ANNUAL REPORT



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*Financial Outlook*

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*The Next Five Years*

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## FINANCIAL OUTLOOK: THE NEXT FIVE YEARS

The *Financial Section* of our Annual Report includes:

- a discussion of the FY 2002 results (Management Discussion and Analysis)
- the FY 2002 financial statements and related note disclosures.

In this section of our report, we take a look at our anticipated future potable and reclaimed water sales revenues and operating expenses, our capital program, and the resulting Five-Year Financial Plan.

### **Revenue Outlook**

While we have been experiencing a downward trend in customer usage per service connection, our FY 2002 potable water *sales volume* (48,015,870 Ccf or 34.7 billion gallons) was at an all time high. Customer usage per service connection increased in FY 2002 to around 20.3 Ccf of usage on average per month, or 1 Ccf more per month than in FY 2001. Despite this upturn in usage per service, FY 2002 simply caused a modest adjustment in the slope of the downward trend. This adjusted trend will influence the shorter term, typically three-year, averages used in projecting our water sales revenues. That, along with continued strong service connection growth, will result in somewhat more robust potable water sales revenue forecasts than in prior years.

We project continued growth in connections to our reclaimed system resulting in increased water sales volumes. By FY 2008 we project our reclaimed water sales will be nearly 14, 000 acre feet.

The major revenue change we are expecting during the next five years, however, will not be in water sales revenues but rather in fees affecting new development. We anticipate a staged set of fees, beginning in FY 2003, with explicit charges for reviewing and approving new development water system plans and inspecting such projects during construction. During FY 2003 we plan to explore development of a water system capacity 'buy-in' fee. This fee will recover a proportionate share of the cost of existing system capacity from which new connections benefit but do not currently fund.

### **Operating Expenses Outlook**

Managing our operational expenses will be a significant challenge in the future. Operating expenses are anticipated to increase over the next five years due to continued customer growth, the utilization of an increasing amount of both CAP water (at increasing rates) and power for operation of the completed the Clearwater Renewable Resource Facility (CRRF), increasing employee related costs, particularly those related to health care, and general inflationary pressures. The potential for the volatility in power rates experienced in recent years to continue remains a concern.

We also plan on purchasing additional allocations of CAP water: 1,500 acre-feet in FY 2003 and 8,206 acre-feet in FY 2005. While we are not currently using all of our allocation, acquisition of a renewable water source will prove valuable to our community in the future. These purchases will increase our CAP capital costs by approximately \$400,000 annually during FY 2003 and FY 2004, and approximately \$1.4 million annually from FY 2005 through FY 2009.

We have continued progress on the implementation of both our *Maintenance Management Program (MMP)*, which has identified new approaches to the operation and maintenance of our water systems, and our Geographic Information System (GIS). A pilot phase of the MMP, covering about 20% of our service area, is scheduled to begin in February 2003. The improved way of doing business is expected to generate both substantial reductions in operating expenses and improved customer service. Attaining these results will, however, require significant investment in staff training, equipment, and related technologies. During the next five years, we have programmed an additional \$7 million for implementation of the MMP. We project the MMP will generate \$3 million in savings during the next four years, and nearly \$2 million annually thereafter, generating a breakeven point in FY 2008.

Additionally, we intend to continue our employee-driven re-engineering efforts, which



## FINANCIAL OUTLOOK: THE NEXT FIVE YEARS

began several years ago, throughout all areas of our organization. We are optimistic that through MMP, GIS, re-engineering and similar programs, we will identify operational efficiencies enabling us to continue to provide potable and reclaimed water to our customers at affordable rates.

### ***Capital Expenditure Outlook***

Over the next five years, we plan to spend an additional \$244 million to fund capital projects that will enable us to continue to provide a safe and adequate supply of potable water and to expand the reclaimed system.

We have structured our five-year Capital Improvement Program around the utility's goals to increase water production, provide additional storage, and improve operational efficiencies. The five-year program includes projects to drill and equip 10 wells, and construct 7 potable storage facilities and 4 reclaimed reservoirs. Funding is also included to construct or enhance 52 miles of potable transmission and distribution mains, as well as 26 miles of reclaimed transmission and distribution mains. Construction of a managed effluent in-channel storage and recovery facility will provide additional reclaimed capacity of approximately 2,500 acre feet per year.

### ***Financial Planning Outlook***

Each year, we develop a rolling six-year *Financial Plan (current year plus five)*. This plan is built on our projected capital improvement and operating budgets, and our projected water sales revenues under existing rates. Our plan is aligned with the City of Tucson's budgetary process. This alignment enables Mayor and Council to be provided with the water revenue increases necessary to support operating and capital needs (over the five years of our financial plan period) *prior* to their review of those capital and operating budgets. As a result, our governing body has the opportunity to know the revenue / rate effects of the capital and operating plans being considered and can adjust the plans if the revenue / rate effects are not deemed acceptable.

Our Financial Plan for the period FY 2003-FY 2007, which was adopted by Mayor and Council during

June 2002, calls for annual water revenue adjustments of 4.3%. In the past, increased revenues have been provided primarily through adjustments to our water rates. Primary drivers behind the need for increased revenues include the operational costs of the CRRF project (increased power and CAP water) and the financing of our capital program.

The capital improvements needed to provide capacity to our customers are generally constructed in large increments; therefore, our system expansions are often constructed years in advance of when the added capacity will be fully utilized. As a result, current system users have been charged rates that are used to pay for a portion of the system capacity that will serve future users. During FY 2003, we will be looking at mechanisms to compensate our existing customers for the costs they have incurred to provide this capacity. The fees, which would be collected at the time of connection to the system, will be designed to recover the capital investment made to provide the capacity to serve new users. Should Mayor and Council choose to implement the fees, the amount of increased revenue required from monthly water use rates will be reduced.

We believe our financial planning process, combined with our ongoing focus on cost reductions and improved efficiencies, positions us to meet our goals of reduced dependence on groundwater and continued delivery of affordable, high quality water.



*The University of Arizona uses reclaimed water in its cooling towers, a major user of campus water.*

## 2002 ANNUAL REPORT



Delivering  
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*Financial Section*

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*Management Discussion and Analysis*

*CITY OF TUCSON OFFICIALS*

MAYOR  
Robert E. Walkup

CITY COUNCIL  
José J. Ibarra  
Carol W. West  
Kathleen Dunbar  
Shirley C. Scott  
Steve Leal  
Fred Ronstadt

CITY MANAGER  
James R. Keene, Jr.

DIRECTOR OF WATER  
David Modeer

DIRECTOR OF FINANCE  
Kay L. Gray

**FISCAL YEAR 2002: MANAGEMENT DISCUSSION AND ANALYSIS****Overview**

Tucson Water is an enterprise fund of the City of Tucson, Arizona. This means we operate similarly to a private business, covering all costs of doing business with revenues from operations. Our fiscal year runs from July 1 through June 30. Our authority and responsibility is derived from the City's Charter and ordinances and resolutions of the Mayor and Council. We provide water service to approximately 680,000 people (about 85% of the greater Tucson metropolitan area's total population) within a 300 square-mile service area that lies within Pima County. Last year we averaged 200,000 customer connections to our water system. We delivered nearly 36 billion gallons (over 110,000 acre-feet) of potable water (enough water to fill nearly 2.3 million residential swimming pools). Additionally, we delivered 3.7 billion gallons of reclaimed water for turf irrigation.

**UNITS OF MEASURE:****1 ACRE FOOT = 325,851 GALLONS****1 CCF = 748 GALLONS****Operations****Potable Water**

During FY 2002, we obtained our municipal potable water (water meeting or exceeding all federal, state, and local drinking water standards) from our groundwater well fields and a facility where we recharge and recover Colorado River water.

Our groundwater is supplied from four well fields (Central, Avra Valley, Santa Cruz, and Southside). These four well fields had an aggregate capacity of 155 million gallons per day during the year.

Our surface water source contract with the United States Department of the Interior and the Central Arizona Water Conservation District (CAWCD) provides us access to 134,466 acre-feet annually of Colorado River water, delivered via the Central Arizona Project (CAP). The CAP consists of 335 miles of waterworks and associated facilities designed to deliver water from Lake Havasu on the Colorado River to Maricopa, Pinal, and Pima Counties in central/southern Arizona.

<b>FY 2002 AVERAGE CUSTOMER CONNECTIONS</b>	<b>200,187</b>
<b>FY 2002 CUSTOMER GROWTH</b>	<b>2.8%</b>
<b>MILES OF PIPELINE</b>	<b>4,200</b>
<b>WELLS</b>	<b>221</b>
<b>RESERVOIRS</b>	<b>51</b>
<b>STORAGE CAPACITY</b>	<b>286 MILLION GALLONS</b>

FY 2002 production from our Clearwater Renewable Resource Facility (CRRF), an \$81 million project that produces a blend of recharged and recovered CAP water and groundwater, was 26,000 acre-feet (18 Mgd). The facility's recharge and recovery production will be increased as the facility is expanded. CRRF, constructed west of the City of Tucson, is composed of recharge basins, recovery well fields, reservoirs and transmission facilities. The facility, at build-out in late FY 2003, will recharge and recover 60,000 acre-feet of CAP water annually (54 Mgd) and meet over fifty percent of our customers' demand for potable water. Our Clearwater project enables a significant portion of our customers' demand for potable water to be met with Colorado River water, a renewable source. As a result, pumpage from the central well field, over which the majority of the City of Tucson lies, can be reduced, thereby easing concerns related to land subsidence.

**PRODUCTION FROM  
CLEARWATER FACILITY**

<b>FY</b>	<b>ACRE-FEET</b>
<b>2001</b>	<b>3,300</b>
<b>2002</b>	<b>26,000</b>
<b>2003*</b>	<b>40,900*</b>
<b>2004*</b>	<b>60,000*</b>

\*Projected

**FISCAL YEAR 2002: MANAGEMENT DISCUSSION AND ANALYSIS****Reclaimed Water**

In 2002, reclaimed water sales were 9.4% of our total water sales volume. However, reclaimed water will play an important role in our future water supply program. Tucson Water has the right to use over half of the effluent produced at the metropolitan wastewater treatment facilities owned and operated by Pima County. Planning for use of this water resource was initiated in 1982 and we began delivering reclaimed water to customers for turf irrigation in 1984. The reclaimed water we produce meets the State of Arizona standards for Class A water (water suitable for: irrigation of sites having unrestricted public access, cooling towers, use on vegetable gardens and orchards, and toilet flushing.)

Our reclaimed system currently includes a treatment plant which filters secondary effluent; a wetlands which biologically treats the backwash water from the filtration plant; constructed basins for the recharge of secondary effluent; and wells to recover the recharged water. This recovered water is blended with water produced at our filtration plant and distributed to customers throughout the reclaimed system.

We plan to obtain our next increment of reclaimed water supply from a managed in-channel recharge and recovery project which will recover, via wells, some of the effluent that has been discharged by the Pima County Wastewater treatment plants into the nearby Santa Cruz River. This project will produce an additional 2,500 acre-feet of reclaimed water annually.

We will continue to work with our customers and other agencies to identify additional reclaimed water uses, thereby transferring the demand from potable to reclaimed water.

***Discussion of Basic Financial Statements***

We account for our activity on the accrual basis of accounting, in conformance with all applicable Governmental Accounting Standards Board (GASB) Statements, including GASB Statement No. 34, *Basic Financial Statements and Management Discussion and Analysis for State and Local Governments*, and the related Statement numbers 36 (Recipient Reporting for Certain Shared Nonexchange Revenue), 37 (Basic Financial Statements-and Management's Discussion and Analysis-for State and Local Governments: Omnibus), and 38 (Certain Financial Statement Note Disclosures. These statements did not significantly change the reporting model shown in our Financial Report. There were no prior year restatements of beginning fund balance/net assets necessary for the implementation of these GASB statements. In conformance with GASB 34, certain assets and liabilities reported as restricted in the fiscal year 2001 annual report's balance sheet are shown as unrestricted on the Statement of Net Assets contained in this report.)

Our annual financial reporting includes three basic financial statements (and accompanying notes) and four supplemental schedules.

<b>STATEMENT/SCHEDULE</b>	<b>DESCRIPTION/PURPOSE</b>
Statement of Net Assets	A summary of our current and long-term obligations and our assets available to meet those obligations. The difference between total assets and total obligations represents our net assets.
Statement of Revenues, Expenses, and Changes in Net Assets	A summary of our revenues and our operating and non- operating expenses, and the resulting change in net assets.
Statement of Cash Flows	A summary of our cash sources, including proceeds from the sale of water revenue bonds, and our use of cash.

**FISCAL YEAR 2002: MANAGEMENT DISCUSSION AND ANALYSIS**

Supplemental Schedule of Net Revenue Available for Debt Service	Calculation of the percentage by which revenues, after meeting operational expenses, exceed revenue bond debt service. Bond covenants require maintaining debt service coverage of 1.75.
Supplemental Schedule of Flow of Funds	A summary of our FY 2002 results commensurate with the methodology we use in establishing water rates.
Supplemental Schedule: Ratio of Outstanding Water Revenue Bonds to Fixed Assets	A calculation of the Utility's outstanding water revenue bond debt as a percentage of depreciated fixed assets.

**Financial Highlights/Condensed Financial Information**

Net Assets: Our total assets exceeded our total liabilities at the close of the fiscal year by \$553.7 million, an increase from FY 2001 of \$15.7 million. Of this amount, \$5.8 million was restricted for capital projects or debt service. At June 30, 2002 we had capital assets, net of depreciation, of \$827.4 million, and outstanding long-term debt of \$326.7 million.

**Tucson Water Summarized Schedule of Net Assets as of June 30 (\$ in millions)**

	<b>2002</b>	<b>2001</b>
Current Assets	\$ 38,998	\$ 20,682
Restricted Assets	45,179	16,568
Other Assets	6,969	12,295
Capital Assets	<u>827,353</u>	<u>806,380</u>
Total Assets	918,499	855,925
Current Liabilities	19,198	16,318
Liabilities from Restricted Assets	18,903	32,576
Long-term Debt Outstanding	<u>326,688</u>	<u>269,062</u>
Total Liabilities	364,789	317,956
Net assets		
Invested in capital assets, net of debt	515,706	514,948
Restricted	5,763	1,632
Unrestricted	<u>32,241</u>	<u>21,389</u>
Total Net Assets	<u>\$ 553,710</u>	<u>\$ 537,969</u>

Revenues: Potable and reclaimed water sales revenues make up approximately 90% of our annual revenues. During FY 2002 we set records for both water sales *volume* (53 million Ccf) and water sales *revenues* (\$98.5 million). Revenues increased by \$12.8 million from FY 2001; potable sales and reclaimed sales were higher by \$11.5 million and \$1.3 million, respectively.

FY 2002 other revenues increased from FY 2001 by \$5.7 million. The increase resulted largely from a settlement with Oro Valley under which outstanding water issues were resolved. Under the settlement agreement, Oro Valley will remit to Tucson Water, over a ten-year period, approximately \$5,410.



## FISCAL YEAR 2002: MANAGEMENT DISCUSSION AND ANALYSIS

Expenses: The majority of our operating costs are fixed, at least in the twelve months of our fiscal year. Approximately 65%-70% of our annual operating expenses will not vary as a result of the quantity of water we sell. Staff related expenses, payments to the City of Tucson for administrative support, and CAP capital payments are our most significant fixed items. The remaining 30%-35% of our operating expenses are made up of expenses that *vary* with the quantity of water produced (power costs, purchase of CAP water, chemicals) or are of a *discretionary* nature, for example, community relations, training, consultants.

FY 2002 operating costs were \$4.8 million higher than FY 2001 costs. Major contributors to cost

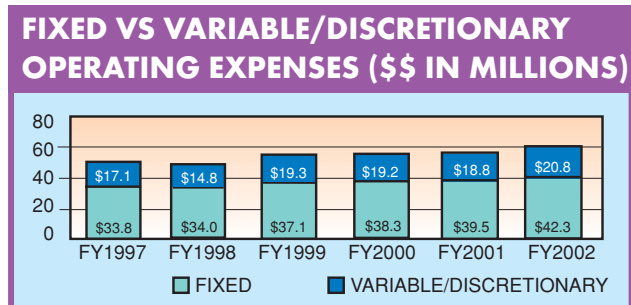
increases included:

Fixed Costs (\$2.8 million)

- increased employee costs (\$1.6 million) resulting from cost of living adjustments, employee merits, and increases in employee insurance costs
- increased administrative service charges (\$1.1 million) resulting from an updated administrative overhead cost allocation study
- increased liability insurance (\$.3 million)

Variable/Discretionary Costs (\$2.0 million)

- increased power costs (\$1.8 million) resulting from increased water sales and increased power rates
- increased costs for CAP water (\$.5 million) reflecting our growing utilization of this renewable resource



Prior Period Adjustments: During FY 2002, we recorded two adjustments to beginning fund equity: (1) the write-off of \$3.9 million in capital assets that had been replaced in previous fiscal years, but not removed from our asset inventory; and (2) an increase to accumulated depreciation of \$3.6 million, resulting from a change in depreciation method.

### Tucson Water Summarized Statement of Revenues, Expenses and Changes in Net Assets Fiscal Years Ending June 30 (\$ in millions)

	2002	2001
Operating Revenues:		
Water Sales	\$ 97,483	\$ 84,771
Other Revenues	15,311	9,635
Total Operating Revenues	112,794	94,406
Operating Expenses	85,209	74,306
Net Operating Income	27,585	20,100
Non-Operating Income	2,062	1,723
Non-Operating Expenses	16,369	15,603
Income before Capital Contributions/Adjustments	13,278	6,220
Capital Contributions	9,972	11,225
Prior Period adjustment	(7,509)	-
Change in Net Assets	\$ 15,741	\$ 17,445

The remainder of this *Management Discussion and Analysis* provides a look into our fiscal year 2002 revenues, operating expenses, capital outlays, debt service, changes in net assets, and cash flows.



## FISCAL YEAR 2002: MANAGEMENT DISCUSSION AND ANALYSIS

**Revenues**

Approximately 90% of our annual revenues are generated by the sale of water (we have customers inside and outside the corporate limits of the City of Tucson). The remaining 10% comes mainly from fees charged for connecting to the water system, customer service charges for account set-up and delinquency processing, billing services provided to other entities, and interest earnings.

FY 2002 water sales revenues of \$98.5 million increased by approximately 15%, or about \$12.8 million, from FY 2001, likely the result of growth in new connections and a year that was hotter and drier than normal. They also exceeded the forecast for the year by slightly over 5%, or \$5.1 million. Other revenues of \$11.0 million were \$0.5 million (5.1%) greater than in FY 2001 and about \$0.4 million (3.9%) greater than the forecast for the year.

**Potable Water Sales, Services, Revenue Effects**

FY 2002 potable water sales *revenues* increased significantly, by 14.2% (\$11.5 million) from FY 2001, and exceeded the forecast for the year by about \$4.1 million, or 4.4%. In fact, the FY 2002 potable water sales revenues of \$92.9 million are the highest in our history.

**KEY DATA**

	2002 ACTUAL	2002 PLANNED	2001 ACTUAL
(\$ IN MILLIONS)			
<b>TOTAL WATER SALES REVENUES<sup>1</sup></b>	<b>\$98.5</b>	<b>\$93.4</b>	<b>\$85.7</b>
<b>POTABLE</b>	<b>\$92.9</b>	<b>\$88.8</b>	<b>\$81.4</b>
<b>RECLAIMED</b>	<b>\$5.6</b>	<b>\$4.6</b>	<b>\$4.3</b>
<b>OTHER REVENUES<sup>2</sup></b>	<b>\$11.0</b>	<b>\$10.6</b>	<b>\$10.5</b>
<b>TOTAL WATER SALES (CCF<sup>3</sup>)</b>	<b>53,006,094</b>	<b>50,622,302</b>	<b>48,474,386</b>
<b>POTABLE</b>	<b>48,015,870</b>	<b>46,448,818</b>	<b>44,373,795</b>
<b>RECLAIMED</b>	<b>4,990,224</b>	<b>4,173,484</b>	<b>4,100,591</b>
<b>AVERAGE MONTHLY CONNECTIONS</b>	<b>200,187</b>	<b>199,670</b>	<b>194,567</b>
<b>POTABLE METERED</b>	<b>197,162</b>	<b>196,715</b>	<b>191,815</b>
<b>FIRE PROTECTION</b>	<b>2,449</b>	<b>2,363</b>	<b>2,263</b>
<b>RECLAIMED METERED</b>	<b>576</b>	<b>592</b>	<b>489</b>
<b>POTABLE WATER 12-MONTH AVERAGE USE PER SVC PER MONTH (CCF)</b>	<b>20.30</b>	<b>19.68</b>	<b>19.29</b>
<b>SINGLE FAMILY CUSTOMERS ONLY</b>	<b>12.59</b>	<b>11.98</b>	<b>11.70</b>

<sup>1</sup> Total water sales revenue includes revenue generated by usage rates, fixed monthly charges based on meter size, and special surcharges based on water usage.

<sup>2</sup> Other revenues include bond fund and other restricted interest earnings. Developer-contributed infrastructure and a settlement whose proceeds will be received over time have been excluded from other revenues here.

<sup>3</sup> 1 ccf = 748 gallons.

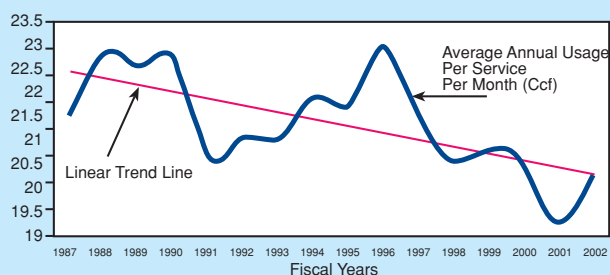
As the revenue information would suggest, our FY 2002 potable water sales *volume* (48,015,870 Ccf or 35.9 billion gallons) more than met expectations. The chart which follows shows the variability of potable water sales over a seven-year period. The chart reveals that FY 2002 sales represent a seven-year high. It is also the most potable water we have sold in our history.

Nothing illustrates better the volatility of our water sales than the relationship between FY 2002 and FY 2001: an 8% increase in sales in FY 2002, preceded by a 4% decline in FY 2001. Management discussions in prior years have noted that water sales, and resulting revenues, are influenced by many factors: for example, *weather, plumbing codes encouraging or enforcing low water use fixtures and appliances in new construction,*

## FISCAL YEAR 2002: MANAGEMENT DISCUSSION AND ANALYSIS

landscaping codes encouraging low water use plants, on-going conservation programs emphasizing education and behavioral changes, conservation-oriented rate structures, and service connection growth. These factors can combine in ways which make annual water sales very unpredictable, particularly in a growing desert community such as Tucson. We believe *weather*, in conjunction with *continued high growth in service connections*, to be the predominate factor in FY 2002 potable revenue results.

## USAGE PER SERVICE CONNECTION

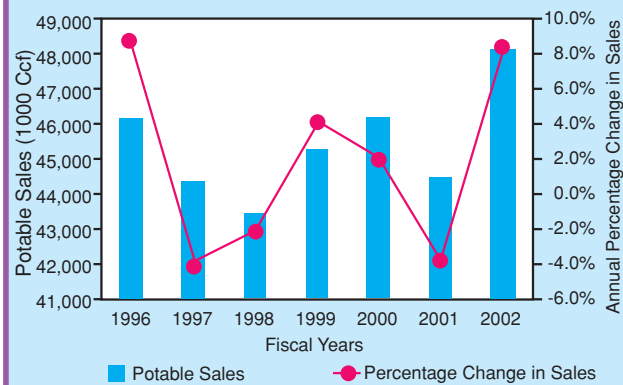


FY 2002 was much drier (just over 4 inches of rainfall) than FY 2001 (around 14 inches of rainfall) and hotter. Relatedly, customer usage per service connection increased in FY 2002 to around 20.3 Ccf of usage, on average per month, or 1 Ccf more per month than in FY 2001. Despite this upturn in usage per service, however, the chart below shows that the trend remains down; FY 2002 simply caused a modest adjustment in the slope of the trend.

*Service connection growth* also pulled potable revenues in a positive direction. Growth in average metered service connections (5,347) duplicated FY 2001 almost exactly (5,301), with 2.8% growth rates in both years. Our average number of active service connections (197,162) for FY 2002 was very close to the forecast of 196,715, exceeding it by 0.2%.

In last year's management discussion, we included information on an enhancement to our conservation oriented rate structures which occurred four months into FY 2001. Our single-family residential customers make up around 90% of the account base and about 60% of annual sales. This customer class is charged under an inclining

## ANNUAL PERCENTAGE CHANGE IN SALES



block rate structure. The October 2000 rate change increased significantly the unit prices for higher usage blocks, including the introduction of a 'super usage' block at a price 78% above the prior price (from \$3.29 to \$5.85 per Ccf).

## PERCENTAGE OF WATER SOLD IN SINGLE FAMILY USAGE BLOCKS

Usage Blocks	FY2002	FY2001
Block 1 (Thru 15 Ccf)	76.8%	78.7%
Block 2 (16-30 Ccf)	16.4%	14.9%
Block (31-45 Ccf)	3.9%	3.6%
Block 4 (Over 45 Ccf)	2.9%	2.9%

The discussion introduced the possibility that 'sticker shock,' in addition to the FY 2001 climate pattern, led to the 4% decline in water sales the Utility experienced that fiscal year, but added a caveat: *How much customers will actually respond to water pricing signals to conserve, as well as the duration of any response, are subjects much debated in the water utility industry.* The table above compares the percentage of water sold in each usage block in FY 2002 with FY 2001; the 'super block' and higher prices for blocks 2 and 3 were in effect for the full 12 months of FY 2002 versus 8 months for the prior year. The results shown by the table may indicate diminished impacts of pricing signals, consumer response to FY 2002 drought conditions, or as some blend of the two possibilities.

## FISCAL YEAR 2002: MANAGEMENT DISCUSSION AND ANALYSIS

Four months into FY 2002, unit prices for the higher usage blocks in the single-family rate structure were again increased. For the two-year period, the rate for the 'super block' increased over 100% (from \$3.29 to \$6.60 per Ccf). The following table compares the 8 months of FY 2001, when the 'super block' and other enhanced rates were initiated, with the same period in FY 2002 when rates for all the higher usage blocks were increased once more. The results shown in the table again may indicate reduced effectiveness, over time, of pricing signals as a conservation strategy and, more particularly perhaps, their effectiveness when drought conditions prevail.

Strictly from a financial perspective, on the other hand, it is the combination of higher water sales and higher rates in FY 2002 which led to the best sales revenue year we have ever experienced.

### ANNUAL PERCENTAGE OF WATER SOLD IN SINGLE FAMILY USAGE BLOCKS (Nov. -June)

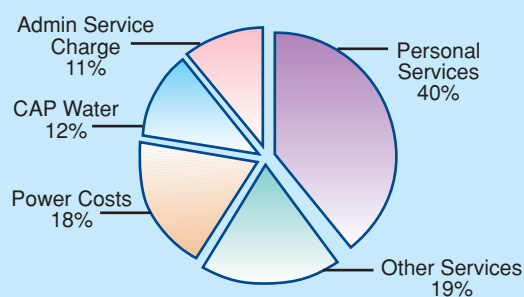
Usage Blocks	FY2002	FY2001
Block 1 (Thru 15 Ccf)	80.1%	83.7%
Block 2 (16-30 Ccf)	14.5%	11.8%
Block (31-45 Ccf)	3.2%	2.5%
Block 4 (Over 45 Ccf)	2.2%	2.0%

### Reclaimed Water Sales, Services, Revenue Effects

FY 2002 reclaimed water sales revenues of \$5.6 million were up about 30% (\$1.3 million) from FY 2001 and about 18% (\$1.0) above forecast. Reclaimed water sales (4,990,224 Ccf or 3.7 billion gallons), accounting for 9.4% of total water sales in FY 2002, were up around 22% from FY 2001 and about 16% in excess of the 2002 forecast. Since the majority of reclaimed water is used for turf irrigation, little rain and high heat, which led to higher potable sales in FY 2002, probably led to higher reclaimed water sales as well. Higher reclaimed rates for the last eight months of FY 2002, applied to the higher sales, also played a part in the increased revenues for the year. Average service connections for FY 2002 increased by 87 to 576 but fell slightly short of the 592

forecasted for the year. As in FY 2001, the majority of our additional service connections were related to residential customers whose irrigation requirements are substantially less than large turf facilities, such as golf courses, which receive reclaimed water. Service connection growth for the year, therefore, contributed only marginally to the increase in revenues.

### FY 2002 OPERATING EXPENSES \$63.1 MILLION



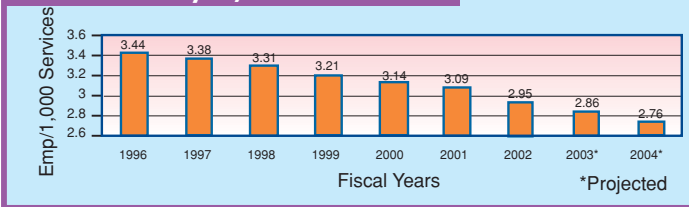
### Operating Expenses

We expend financial resources to operate our two water systems (potable and reclaimed). We incurred \$63.1 million in operating expenses in FY 2002 (excluding depreciation of \$24.8 million and taxes of \$8.7 million) or about \$320 per service account. While we are a large utility with many varied expenses, four cost categories made up over 75% of our total operating costs: employee costs, power costs, CAP water costs, and administrative service charges.

*Employee costs* (\$24.8 million in FY 2002 and \$23.2 million in FY 2001) relate to our diverse staff of 586 employees. These employees serve in varying roles: planning for our community's growing water resource needs; insuring the quality of the water we deliver; designing storage and delivery systems to meet our customer demands; providing proper maintenance to all elements of our system; and providing customer service through accurate meter reading and billing. The \$1.6 million increase from FY 2001 was the result of cost of living adjustments, employee merit increases, and increases in employee insurance premiums.

## FISCAL YEAR 2002: MANAGEMENT DISCUSSION AND ANALYSIS

## EMPLOYEES / 1,000 SERVICES



To control power costs, we have converted, where feasible, to less expensive, interruptible rates and designed our system to operate with a mix of electric and gas powered pumps. In addition, we have successfully negotiated some reduced rates with providers of both electricity and gas.

Despite continuing increases in the number of customers, our ratio of employees per 1,000 metered customer services has steadily decreased in recent years. Restructuring of meter reading routes, flexible work hours, reorganization of field work teams, and increased use of technology and automation continue to contribute to a reduction in the employee per-service ratio.

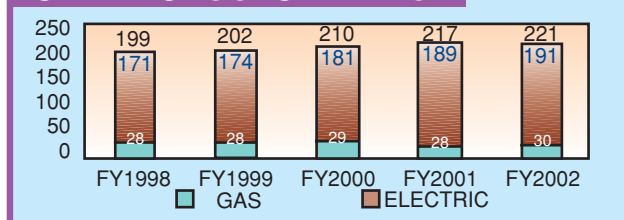
*Power costs* (approximately \$11.6 million and \$9.8 million in FY 2002 and FY 2001, respectively) are incurred as we pump water up from depths ranging to 700 feet and move it through our distribution system. The 18% increase in power costs resulted primarily from two factors: significant increases in rates for electricity and gas, and increased power used to meet the 9% increase in customer water deliveries. Additionally, operation of our CRRF requires increased usage of both electricity and gas. Recharged water, recovered and moved from the CRRF site 21 miles outside of our central service area, will replace numerous wells scattered throughout the central wellfield. A significant increase in power costs will occur with operation of the CRRF at full build out; by FY 2004, we estimate it will cost us nearly \$2 million more annually than pumping (and over-drafting) the central wellfield.

*CAP water costs* (\$7.7 million in FY 2002 and \$7.2 million in FY 2001) result from a contractual obligation for the purchase of CAP water from the Central Arizona Water Conservation District (CAWCD). Our obligation consists of two components: (1) a capital financing charge, \$6 million in both FY 2002 and FY 2001, based on the Utility's allotment of 134,466 acre-feet, and (2) a commodity charge (\$1.7 and \$1.2 million in FYs 2002 and 2001, respectively) based on actual CAP water taken. CAWCD establishes both the capital and commodity rates annually.

Although we purchased approximately 26,500 acre-feet of CAP water in FY 2002, purchases will increase significantly as the CRRF reaches full build-out. CRRF usage of CAP water will increase to 60,000 acre-feet annually by FY 2004.

*Administrative service charges* (\$6.8 and \$5.7 million in FY 2002 and FY 2001, respectively) are our payments to the City of Tucson for support services (procurement/payroll/budget/etc). All payments are for direct services or indirect administrative support; no funds are transferred to support non-Utility related purposes. Over \$1 million of the increase from FY 2001 expenses was the result of an updated administrative overhead cost allocation study conducted by the City of Tucson. In addition, the Utility's funding of these allocated overhead costs was increased from partial to full funding (85% of calculated cost in FY 2001 to 100% in FY 2002).

## TOTAL PRODUCTION WELLS





**FISCAL YEAR 2002: MANAGEMENT DISCUSSION AND ANALYSIS**

*We report our operating expenses under five divisions, along with CAP water and general expenses.*

**CHANGE IN OPERATING EXPENSES FY 2001 TO 2002 (\$\$ IN MILLIONS)**

Operating Expenses (excluding depreciation/discounts)	FY 2002	FY 2001	Increase
Director's Office	\$2,350	\$1,891	\$459
Business Services	\$8,760	\$8,596	\$164
Water Operations	\$26,615	\$24,674	\$1,941
Planning and Engineering	\$2,832	\$2,629	\$203
Water Quality Management	\$7,199	\$6,820	\$379
CAP water charges	\$7,673	\$7,169	\$504
General expenses	\$7,700	\$6,567	\$1,133

- *Increases in Director's Office, Business Services, Planning and Engineering, and Water Quality Management were largely related to increases in employee costs.*
- *Increases to Water Operations were the result of increased employee costs and increased power expenses.*
- *Increased purchases of CAP water generated the increased CAP expenses.*
- *Increases to General expenses were primarily related to increased administrative service charges.*

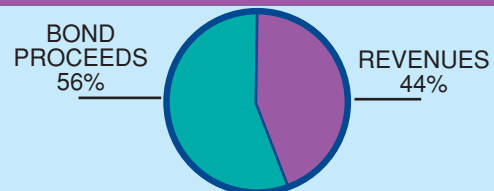
**Capital Improvements**

At the end of FY 2002, our water system was composed of 204 active wells, 4,200 miles of delivery pipelines, 124 boosters to move water around our delivery area, and 51 reservoirs to store water to meet peak demands. We continue to plan, design, and construct improvements to our system infrastructure to meet the demands of our current and future customers.

We fund our capital program with a combination of current revenues (cash from the sale of water to our customers) and bond proceeds (cash from the sale of revenue bonds). This enables both current and future customers to participate in the funding of capital improvements. In May 2000, the citizens of Tucson approved a \$123.6 million Water Revenue Bond authorization. This authorization is anticipated to provide the funds to meet our bond requirements through FY 2005.

During FY 2002, we spent over \$40.5 million (or 74% of our fiscal year capital budget) on improvements to our system. In FY 2001, \$54.7 (88% of budget) was expended in our capital program. During FY 2002, we dealt with staffing

vacancies and vendor difficulties in delivery of the CRRF raw water pipeline (used to transport CAP water from the canal to the recharge basins); these were major contributors to the decrease in spending and percentage of budget spent.

**FUNDING OF FY 2002 CAPITAL IMPROVEMENTS: \$40.5 MILLION**

## FISCAL YEAR 2002: MANAGEMENT DISCUSSION AND ANALYSIS

During FY 2002, nearly \$11.4 million was spent on the CRRF project for construction of the raw water pipeline and additional recharge basins, and for expansion of the recovery wellfield (well drilling and equipping). The remaining \$29.1 million was spent on the following programs:

- Transmission and Distribution Mains \$ 10.8 million
- Reclaimed System Expansion and Improvements \$ 3.7 million
- Equipment/Vehicles \$ 2.9 million
- New Services (water meters, minor extensions) \$ 2.7 million
- General Plant Improvements \$ 2.3 million
- Reservoirs and Pumping Facilities \$ 2.0 million
- Recharge and Recovery \$ 1.6 million
- Well Drilling, Equipping, and Upgrades \$ 1.6 million
- Other \$ 1.5 million

### *Debt and Debt Service*

At June 30, 2002, we had \$335 million in outstanding bonds. Water revenue bond interest payments (\$15.8 million in FY 2002) are reported as expenses on our income and flow of funds statements. Repayment of principal (\$7.5 million in FY 2002) is reported on our flow of funds statement. In addition, we paid \$0.2 million in fiscal agent fees.

During FY 2002, we entered into three long-term debt agreements, in each case establishing repayment of principal and interest over a twenty-year period:

Date	Amount (in millions)	Type	Interest Rate
July 1, 2001	\$37.8	Water Revenue Bonds	5.11%
Dec. 21, 2001	\$ 8.8	Water Infrastructure Finance Authority Loan	3.43%
June 27, 2002	\$18.9	Water Revenue Bonds	4.75%

The financing of our capital program with a combination of bond proceeds/loans *and* water sales revenues insures a healthy ratio of outstanding water revenue bond debt to system fixed assets. This ratio has averaged .34 over the last five years (see Supplemental Schedule III).

### **BOND RATINGS**

	June 30,	
	2002	2001
• Moody's Investors Service	Aa3	Aa3
• Standard and Poors	A+	A+

### *Change in Net Assets and Flow of Funds*

The change in net assets is the amount by which our revenues and capital contributions exceed our expenses, including depreciation. The change in net assets for FY's 2002 and 2001 was \$19.6 and \$17.4 million, respectively. Two unusual items affecting the change in net assets occurred during FY 2002:

1. A settlement of legal issues with the Town of Oro Valley (related to CAP water allocations and other water issues) resulted in revenues of \$5.4 million. The actual proceeds from the settlement will be received over a 10 year period.
2. A change in the method we use to depreciate our fixed assets was the major factor in an \$8.8 million increase to FY 2002 depreciation expense.

## FISCAL YEAR 2002: MANAGEMENT DISCUSSION AND ANALYSIS

The effect of these items is removed for comparison purposes:

	<u>FY 2002</u>	<u>FY 2001</u>
Change in Net Assets (in millions)	\$ 19.6	\$17.4
Remove: Settlement Revenues	(5.4)	-
Increased depreciation – FY 2002	8.8	-
Adjusted Change in Net Assets	<u>\$23.0</u>	<u>\$17.4</u>

When adjusted, the FY 2002 change in net assets surpassed FY 2001 by \$5.6 million.

<b>FY2002 CHANGE IN NET ASSETS - INCREASE OVER FY 2001</b>	
	<u>(\$ in millions)</u>
<i>Revenues</i>	
Increase in water sales (potable and reclaimed)	\$ 12.7
Increase in other revenues	0.3
<i>Expenses</i>	
Increase in power expense	-1.8
Increase in employee costs	-1.6
Increase in administrative service charge	-1.1
Increase in interest expense	-0.9
Increase in CAP water expense	-0.5
Increase in other expenses	-0.3
<i>Capital Contributions</i>	
Decrease in contributed water systems	-1.2
Change in Net Assets FY 2002 over FY 2001	<u>\$ 5.6</u>

Since we operate as a self-supporting utility of the City of Tucson, we must receive adequate cash (from revenues) during the year to support our operating *and* capital improvement cash requirements. In addition, we must meet financial policies governing *cash reserve balances* and *debt service coverage*. For this reason, we focus more on our projected and actual *flow of funds* than on *net income*.

**Cash Reserves** - During June 2002, the Mayor and Council adopted a Financial Plan that increases the Utility's cash reserve level to approximately \$12.6 million by the end of FY 2006. At June 30, 2002, unrestricted/ undesignated cash on hand was \$11 million.

**Debt Service coverage (the % by which revenues, after meeting operating cash needs, cover bond principal and interest payments)** - Bond covenants and Mayor and Council policy require us to maintain an annual average debt coverage of at least 1.75. Debt service coverage for FY 2002 was 2.06.



## FISCAL YEAR 2002: MANAGEMENT DISCUSSION AND ANALYSIS

Our flow of funds does not include depreciation (a non-cash expense *included* in our income statement), but does include cash outlays for capital improvements and debt principal repayments (cash use items *not included* in our income statement). In addition, revenues resulting in long-term receivables, such as the Oro Valley settlement, are included in our flow of funds the year in which we receive payments.

The following “summary flow of funds” identifies the major cash sources and uses during FY 2002:

SUMMARY FY 2002 FLOW OF FUNDS (\$ in millions)			
<b>CASH INFLOWS:</b>			
<b>What we received:</b>			
from sale of water*	\$98.4		
from other revenues/sources**	19.4		
<b>TOTAL INFLOWS</b>			<b>\$117.8</b>
<b>CASH OUTFLOWS &amp; USES</b>			
<b>How much of our revenues we used for:</b>			
operations/maintenance***	\$71.7		
debt service (principal/interest)	23.5		
capital improvements	17.9		
contribution to reserves	4.3		
other purposes	.4		
<b>TOTAL OUTFLOWS</b>			<b>\$117.8</b>
*includes CAP surcharge revenues			
** includes taxes			
*** includes taxes and payment to City of Tucson for administrative support			

### *Requests for Financial Information*

Our annual report is intended to provide our customers, investors, and creditors with an overview of our operations and related financial activities. If you have any questions about our annual report or need additional financial information, contact Tucson Water Financial Services, P.O. Box 27210, Tucson, AZ 85726-7210 (520) 791-2666.

## 2002 ANNUAL REPORT



Delivering  
Quality Water  
to a Desert Community

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*Financial Section*

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*Financial Statements*

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## TUCSON WATER

An Enterprise Fund of the City of Tucson, Arizona

June 30, 2002

(Dollar amounts in thousands)

**STATEMENT OF NET ASSETS****Current assets:**

Cash and cash equivalents	
Undesignated	\$ 11,040
Designated for customer deposits	731
Designated for infrastructure replacement	9,326
Total cash and cash equivalents	<u>21,097</u>

Billed accounts receivable, net of allowance for doubtful accounts of \$801	11,352
Unbilled accounts receivable	6,088
Prepays and other assets	<u>461</u>

<b>Total current assets</b>	<u>38,998</u>
-----------------------------	---------------

<b>Restricted assets</b>	45,179
<b>Investments for contract payments</b>	1,307
<b>Long-term accounts receivable</b>	4,327

**Capital assets:**

Utility property, plant and equipment	948,617
Construction-in-progress	95,850
Less accumulated depreciation	<u>(217,114)</u>

<b>Net capital assets</b>	<u>827,353</u>
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<b>Other</b>	<u>1,335</u>
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<b>Total assets</b>	<u><u>\$ 918,499</u></u>
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**STATEMENT OF NET ASSETS (CONTINUED)****Liabilities and net assets****Current liabilities:**

Accounts payable	\$ 6,835
Salaries, wages and payroll taxes payable	3,084
Current installments of revenue bonds payable	8,102
Current installments of contract payable	339
Refundable/customer deposits deposits	731
Accrued interest payable	107

**Total current liabilities** 19,198

**Liabilities payable from restricted assets** 18,903

**Long-term liabilities**

Revenue bonds payable	324,301
Contract payable	850
Other long-term liabilities	1,537

**Total long-term liabilities** 326,688

**Total liabilities** 364,789

Commitments, contingencies and subsequent events

(notes 13, 14, 15, 16, and 17)

**Net assets**

Invested in related capital assets net of debt	515,706
Restricted for:	
Capital Projects	5,665
Debt Service	98
Unrestricted	32,241

**Total net assets** \$ 553,710

See accompanying notes to financial statements.



## TUCSON WATER

June 30, 2002

An Enterprise Fund of the City of Tucson, Arizona

(Dollar amounts in thousands)

**STATEMENT OF REVENUES, EXPENSES, AND CHANGES IN NET ASSETS**

## Operating revenues:

Potable water sales	\$ 91,916
Reclaimed water sales	5,567
Total water sales	<u>97,483</u>
Central Arizona Project surcharge	963
Connection fees	3,151
Billing services -	
Pima County Sewer, City of Tucson Solid Waste	1,419
Settlement with Oro Valley (note 5b)	5,410
Miscellaneous:	
TCE Cleanup reimbursement	667
Area development fees	1,488
Service charges	1,356
Reimbursed prior year expenses	695
Other	<u>162</u>
Total miscellaneous	<u>4,368</u>
Total operating revenues	<u>112,794</u>

## Operating expenses:

Director's office:	
Personal services	1,159
Contractual services	1,008
Commodities	<u>183</u>
Total director's office	<u>2,350</u>
Business services:	
Personal services	6,034
Contractual services	1,347
Commodities	<u>1,379</u>
Total business services	<u>8,760</u>
Water operations:	
Personal services	11,095
Contractual services	12,608
Commodities	<u>2,912</u>
Total water operations	<u>26,615</u>
Planning and engineering:	
Personal services	2,282
Contractual services	322
Commodities	<u>228</u>
Total planning and engineering	<u>2,832</u>
Water quality management:	
Personal services	3,698
Contractual services	2,736
Commodities	<u>765</u>
Total water quality management	<u>7,199</u>
CAP water charges:	
Capital charges	5,985
Commodity charges	<u>1,688</u>
Total CAP water charges	<u>7,673</u>

Continued

## TUCSON WATER

June 30, 2002

An Enterprise Fund of the City of Tucson, Arizona

(Dollar amounts in thousands)

# STATEMENT OF REVENUES, EXPENSES, AND CHANGES IN NET ASSETS (CONTINUED)

## Operating expenses: (continued)

## General expenses:

Personal services	581
Contractual services	7,069
Commodities	50
Total general expenses	<u>7,700</u>

Depreciation and amortization (note 2g)	21,160
---	--------

Discount given for early payment (long-term receivable)	920
---	-----

Total operating expenses	<u>\$ 85,209</u>
--------------------------	------------------

Net operating income	<u>27,585</u>
----------------------	---------------

## Nonoperating income:

Investment earnings	1,948
Gain on sale of property/equipment	114
Total nonoperating income	<u>2,062</u>

## Nonoperating expenses:

Interest expense	16,147
Other nonoperating expenses	222
Total nonoperating expenses	<u>16,369</u>

Income before capital contributions	<u>13,278</u>
-------------------------------------	---------------

Capital contributions (note 13)	<u>9,972</u>
---------------------------------	--------------

Change in net assets	23,250
----------------------	--------

Net assets restated - July 1 (note 4)	<u>530,460</u>
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Net assets - June 30	<u><u>\$ 553,710</u></u>
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See accompanying notes to financial statements.

**STATEMENT OF CASH FLOWS**

Cash flows from operating activities:	
Cash received from customers	\$ 111,583
Cash payments to suppliers for goods and services	(51,061)
Cash payments to employees for services	(24,192)
Net cash provided by operating activities	36,330
Cash flows from capital and related financing activities:	
Bond proceeds	64,887
Acquisition and construction of capital assets	(40,657)
Principal paid on capital debt	(7,501)
Interest paid on capital debt	(16,045)
Fiscal agent fees paid on capital debt	(222)
Proceeds from sale of property and equipment	114
Net cash used in capital and related financing activities	576
Cash flows from investing activities: interest on investments	2,106
Net increase (decrease) in cash and cash equivalents	39,012
Cash and cash equivalents at beginning of year	7,488
Cash and cash equivalents at end of year	\$ 46,500
<hr/>	
Reconciliation of operating income to net cash provided by operating activities:	
Operating income	\$ 27,585
Adjustments to reconcile operating income to net cash provided by operating activities:	
Depreciation and amortization	21,160
Decrease (increase) in cash resulting from changes in:	
Accounts receivable	(4,129)
Prepays and other assets	2
Long-term accounts receivable	5,930
Accounts payable	2,426
Accrued expenses	657
Customers/refundable deposits	(1,217)
Due to City of Tucson funds	(16,084)
Net cash provided by operating activities	\$ 36,330
<hr/>	
A reconciliation of cash and cash equivalents at June 30 follows:	
Unrestricted cash	\$ 21,097
Restricted cash (included in restricted assets)	25,403
Cash and cash equivalents at June 30	\$ 46,500

## Noncash investing, capital and financing activities:

Developers contributed water systems to the Utility valued at \$9,972 during the year ended June 30, 2002 .  
Other noncash transaction during the year ended June 30, 2002: an accounts receivable of \$5,410 relating to a legal settlement and \$208 in interest thereon; a discount of \$920 given on early payoff of a long-term accounts receivable.

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## 2002 Annual Report



### Delivering Quality Water to a Desert Community



#### *Notes to Financial Statements*

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**NOTES TO FINANCIAL STATEMENTS****1. DESCRIPTION OF THE BUSINESS**

Tucson Water (the Utility), an enterprise fund of the City of Tucson, Arizona (the City), is operated and maintained as a self-supporting, municipally-owned utility of the City providing customers with potable and reclaimed water. The Utility provides water service to approximately 690,000 people within a 300 square-mile service area that encompasses approximately 85% of the greater Tucson metropolitan area's total population. Customers are classified by the type of service they receive, including residential, multifamily, mobile home park with sub-meters, commercial, and industrial services, and are located both inside and outside of the corporate limits of the City.

**Water Sources**

The Utility currently obtains the majority of its municipal potable water from groundwater supplied from four well fields with an aggregate capacity of 201 million gallons per day (Mgd) during calendar year 2002.

The Utility also has a surface water source under contract with the United States Department of the Interior and the Central Arizona Water Conservation District (CAWCD) for 134,466 acre-feet annually of Colorado River water delivered via the Central Arizona Project (CAP). The CAP consists of waterworks and associated facilities designed to deliver water from Lake Havasu on the Colorado River to Maricopa, Pinal, and Pima Counties in central Arizona. Although owned by the federal government, the CAP is operated and maintained by the CAWCD.

In May 2001, the Utility began delivering water from its Clearwater Renewable Resource Facility (CRRF) which produces a blend of recharged and recovered CAP water and groundwater. The facility is currently capable of recharging and recovering 20,000 acre-feet annually (18 Mgd). CRRF, constructed northwest of the City of Tucson, is composed of recharge basins, recovery wellfields, and storage and transmission facilities. At build-out, expected by June 30, 2003, it will recharge and recover 60,000 acre-feet of CAP water annually (54 Mgd), thereby reducing pumpage from the central well field and helping

to prevent land subsidence in the Tucson metropolitan area.

As part of a 1979 intergovernmental agreement (IGA) transferring the sewer from the City to Pima County, the Utility was granted the right to use 90% of the effluent discharged from the metropolitan wastewater treatment facilities. Planning for use of this water resource was initiated in 1982. In 1984, the Utility began delivering reclaimed water, or effluent treated to tertiary levels, to customers for turf irrigation purposes. The Utility's reclaimed system currently includes a reclaimed water treatment plant which processes effluent to a quality suitable for open-access turf irrigation, a wetlands which biologically treats secondary effluent, basins for the effluent recharge and wells for recovery of the recharged water for delivery in the reclaimed distribution system.

In February 2000, the IGA was amended to resolve issues related to effluent and recharge permits. The amendment contained numerous agreements, including: (1) the City, Pima County and other effluent management entities (Marana/Oro Valley) agreed to establish a Conservation Effluent Pool for use on riparian projects, (2) the City and Pima County agreed to cooperatively plan and establish recharge basins for storage of effluent, (3) effluent from the new treatment facility at Ina Road would be divided among the City, Pima County and U.S. Department of the Interior, (4) the City would no longer control effluent from non-metropolitan treatment plants, and (5) the County could use its 10% of effluent for any public use.

**Assured Water Supply**

Arizona Department of Water Resources' (ADWR) Assured Water Supply (AWS) Program is designed to encourage water providers to shift their reliance from groundwater to renewable water sources. It is important that water systems have an AWS designation because without it, no new growth can take place within the service area unless developers provide their own water supply. Receipt of the Assured Water Supply designation indicates a sufficient water supply is

**NOTES TO FINANCIAL STATEMENTS**

available to meet 100-years of projected demand for the existing population, committed demand (undeveloped, subdivided land within the service area) and provision for an increment of growth. The Utility's service area received a designation of Assured Water Supply on January 1, 1998 based upon its membership in the Central Arizona Groundwater Replenishment District (CAGRDR) and the planned recharge and recovery of CAP water at the CRRF.

**Utility Operations**

The Utility is operated and maintained as a self-supporting, municipally-owned utility of the City. Although the Utility is a department of the City, it is operated in a manner similar to a private business enterprise where the costs of providing goods and services to its customers are financed primarily by user charges. A fund structure separate from other City accounts is maintained. The Utility's authority and responsibility is derived from the City's Charter and ordinances and resolutions of the Mayor and Council of the City. The Utility has within its organization virtually all of the elements of a self-contained entity. The Mayor and Council adopt the Utility's annual budget, establish water rates and fee structures in accordance with State laws governing municipal water systems, and provide overall policy direction.

To assist with the task of operating the Utility, the Mayor and Council have adopted water service policies. A number of these policies establish guidelines for the water financing and ratemaking process. These water service policies include, but are not necessarily limited to, the following concepts:

- All costs associated with the operation of the Utility (operating, maintenance, renewal and replacement, capital and debt service) shall be funded from revenues derived from the Water System's water rates and other water-related income sources.
- Various combinations of revenue bonds, tax-secured bonds and water revenues are used to finance Utility capital improvements; regardless of what type of bond is used, -40-

repayment of the bonds shall be made only from Water System revenues.

- Some portion of the capital improvements are required to be funded from annual revenues to comply with existing bond covenants and Mayor and Council policy and to facilitate new debt issues by maintaining adequate debt coverage. An annual average debt coverage of at least 1.75 shall be maintained. The Utility was in compliance with debt coverage requirements at June 30, 2002 and 2001.
- The policies require the Utility to maintain cash reserves adequate for known future obligations. In June 2002, Mayor and Council adopted a Financial Plan including increasing cash reserve levels to approximately \$12.5 million by the end of fiscal year 2007. Cash reserves are non-restricted cash/equivalents less cash designated for specific purposes. As reported on the *Statement of Net Assets*, the Utility maintains two designations of cash:
  - Designated for customer deposits* – Cash/equivalents designated for reimbursement of customer deposits
  - Designated for infrastructure replacement* – Cash/equivalents designated for replacement of existing water system infrastructure (see note 6b).
- Charges for services shall be made on a cost of service basis. Water rate design elements shall reflect the cost of service areas across customer classes and seasons and shall be designed so as to encourage water conservation and to control peak demand.
- Water rates and charges shall be reviewed annually.

Mayor and Council created the Citizens' Water Advisory Committee (CWAC) in 1977 as the official advisory body to the Council on water issues. The CWAC, composed of fifteen members, annually reviews the Utility's Financial Plan and its underlying capital improvement program, operating plans and revenue forecasts and makes recommendations to the Mayor and Council on rate adjustments.

## NOTES TO FINANCIAL STATEMENTS

### 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

#### a. General

Tucson Water is an enterprise fund of the City. The enterprise fund accounts for the financing and operations of the Utility. All activities necessary to provide water services to Utility customers are accounted for within this enterprise fund. Any Utility annual revenues remaining after providing for operating and maintenance expense and capital project funding are retained by the Utility.

#### b. Basis of Accounting

The Utility accounts for its activity on the accrual basis of accounting. The Utility applies all applicable Governmental Accounting Standards Board (GASB) Statements, as well as the following pronouncements issued on or before November 30, 1989, unless those pronouncements conflict or contradict GASB pronouncements: Financial Accounting Standards Board Statements and Interpretations, Accounting Principles Board Opinions and Accounting Research Bulletins of the Committee on Accounting Procedure. Governments are given the option of whether or not to apply all FASB Statements and Interpretations issued after November 30, 1989, except for those that conflict with or contradict GASB Pronouncements. Tucson Water has elected not to implement FASB Statements and Interpretations issued after November 30, 1989.

#### c. Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions. These estimates and assumptions affect (1) the reported amounts of assets and liabilities, (2) the disclosure of contingent assets and liabilities at the date of the financial statements, and (3) the reported amounts of revenue and expenses during the reporting period. Actual results could differ from these estimates.

#### d. Cash Equivalents

All short-term investments purchased with an

original maturity of three months or less are considered to be cash equivalents. For purposes of the statement of cash flow, all highly liquid investments (including participation in the City of Tucson's investment pool account) are considered to be cash equivalents.

#### e. Investments/Deposits

The Utility participates in the City's external investment pool for all cash balances. Pooled investments are reported at fair value. A single master custodian holds all assets of the investment pool.

#### f. Income and Other Taxes

The Utility is an enterprise fund of the City of Tucson, Arizona, a municipality exempt from federal and state income taxes. Accordingly, no provision for income taxes is included in the financial statements.

Tucson Water is subject to State and municipal (Tucson, South Tucson, Marana) business privilege taxes. In addition, the City of Tucson levies a separate utility tax on the Utility's sales to customers residing within the City of Tucson limits and the State levies an environmental tax (to support Super-fund cleanup efforts) on all potable water sales.

#### g. Capital Assets

Property, plant and equipment acquired prior to June 30, 1965 are stated at estimated historical cost. Additions subsequent to that date are stated at actual historical cost. Depreciation has been provided using the straight-line method over the following estimated useful lives.

<u>Estimated useful life (years)</u>	
Buildings	40
Improvements other than buildings	10 - 40
Wells, reservoirs and improvements	40-100
Machinery and equipment	3 to 20

Depreciation for the year ended June 30, 2002 was \$21,160. Beginning July 1, 2001, the Utility



**NOTES TO FINANCIAL STATEMENTS**

converted from a straight-line depreciation by *asset class* to straight-line depreciation by *individual assets*.

The Utility does not capitalize interest on capital projects unless it is material, using the effective interest method. No interest costs were capitalized during the fiscal years ended June 30, 2002 or 2001, as the amounts were not material. Maintenance and repairs are expensed as incurred.

**h. Deferred Charges**

Deferred charges represent the unamortized costs resulting from the issuance of water revenue bonds. These deferred charges are amortized over the life of the related bonds. Unamortized costs were \$1,092 at June 30, 2002.

**i. Restricted Assets/Liabilities**

In accordance with applicable covenants of Utility bond issues, Mayor and Council Resolutions or other agreements, appropriate assets and liabilities have been restricted.

**3. ACCOUNTING CHANGE AND RESTATEMENTS**

The Utility implemented GASB Statement No. 34, *Basic Financial Statements and Management's Discussion and Analysis for State and Local Governments*, and the related statement numbers 36, *Recipient Reporting for Certain Shared Nonexchange Revenue*; 37, *Basic Financial Statements-and Management's Discussion and Analysis-for State and Local Governments: Omnibus*; and 38, *Certain Financial Statement Note Disclosures* during this fiscal year. These statements changed the reporting model for governmental entities as shown in this Financial Report. Specifically, the statements changed to a net asset presentation, and a defined Management Discussion and Analysis is required.

Within the Utility, an adjustment was necessary to write off certain capital assets that had been replaced in prior fiscal years. Also during FY 2002,

the Utility converted from a straight-line depreciation by asset class to a straight-line depreciation by individual asset. The impact of this change is shown below:

Fund equity reported	
as of July 1, 2001	\$ 537,969
Adjustments:	
Write off of capital assets	(3,894)
Change in depreciation method	(3,615)
Restated net assets, June 30, 2001	<u>\$ 530,460</u>

**4. DEPOSITS/INVESTMENTS**

The Utility had approximately \$14,214 cash held with fiscal agents at June 30, 2002, included in restricted assets in the accompanying statements of net assets. Cash with fiscal agents was covered by collateral held in the fiscal agents' trust departments but not in the Utility's name. Each trust department pledges a pool of collateral against all trust deposits it holds.

At year end, the Utility had \$21,097 in unrestricted cash and cash equivalents. The City Charter and State Statutes authorize the City to invest City investment pool funds in obligations of the U.S. Government, its agencies and instrumentalities, money market funds consisting of the above, repurchase agreements, bank certificates of deposit, commercial paper rated A-1/P-1, corporate bonds and notes rated AAA or AA, and the State of Arizona Local Government Investment Pool. Operating and capital projects funds may be invested for a maximum of 3 years based on projected construction schedules. Since these funds are held by the City of Tucson in its investment pool, they are not categorized by the Utility.

Additional information on the City's investments/deposits, including categorization of the level of custodial credit risk assumed, is provided in the City's Comprehensive Annual Report (CAFR). Copies of the CAFR can be obtained from the City's Finance Department, 255 W. Alameda Street, Tucson, AZ, 85701.

## NOTES TO FINANCIAL STATEMENTS

### 5. ACCOUNTS RECEIVABLE

#### a. Current

The Utility's current accounts receivable at June 30, 2002 were:

Billed Accounts	\$	12,153
Unbilled ( <i>estimated unbilled water sales delivered at June 30</i> )		6,088
Less: Allowance for doubtful accounts		<u>(801)</u>
Total current accounts receivable	\$	<u>17,440</u>

#### b. Long-term

The Utility's long-term accounts receivable at June 30, 2002 were:

Receivable from settlement agreements	\$	4,139
Receivable from local school district		<u>188</u>
Total long-term accounts receivable	\$	<u>4,327</u>

### Settlement Agreements

On September 21, 1992, the City of Tucson and the Metropolitan Domestic Water Improvement District (MDWID) and the Oro Valley Domestic Water Improvement District (collectively, the Districts), entered into an Asset Purchase Agreement. The terms of this agreement required the Districts to purchase treated Central Arizona Project water from the City and to assume the obligations of the Metropolitan Water Company (MWC). The Districts assumed MWC's obligation to pay a pro rata share of the City's cost of importing water and to pay certain operation and maintenance and repair expenses. The Districts decided this arrangement was not in their best interests and refused to pay the City. This resulted in a lawsuit and a countersuit in 1995.

In 1998, a settlement agreement was reached between the City of Tucson and the Districts. Approvals were obtained from the Central Arizona Water Conservation District, the U.S. Government, the Arizona Department of Water Resources, and Pima County, and validated by a court of competent jurisdiction in December 1998. Under this settlement, the Districts agreed to pay

the Utility \$12,297 over 21 years at an interest rate of 5.3%. In return, the Utility agreed to assign 9,500 acre-feet of its annual rights to Central Arizona Project water to the Districts. Oro Valley prepaid its obligation in full during fiscal year 2000.

In November 2001, MDWID proposed early pay off of the loan to the City at a discounted amount. Tucson Water agreed to consider the MDWID prepayment proposal to provide additional funding of the capital program or to fund a capital reserve. After a series of negotiations with MDWID, the Utility agreed to accept prepayment of \$9,303 (the remaining \$10,223 balance discounted at 9%). MDWID paid off the receivable on January 31, 2002. The \$920 discount has been reported as an operating expense on the *Statement of Revenues, Expenses, and Changes in Net Assets*.

On June 3, 2002, the Mayor and Council utilized the payoff proceeds and interest thereon to establish a fund for future infrastructure replacement. The fund's balance at June 30, 2002

**NOTES TO FINANCIAL STATEMENTS**

was \$9,326 and is reported on the *Statement of Net Assets* as cash/equivalents designated for infrastructure replacement.

In 1979, the City of Tucson entered into agreements (the "NW Area Agreements") with water companies in the Northwest Area, including the Foothills Water Company and the Rancho Vistoso Water Company. These agreements called for the City to provide imported water supplies, including CAP water, for a price consisting of the City's treatment and operations costs, plus a capital component for infrastructure necessary to deliver water to the Northwest Area water companies. The Town of Oro Valley purchased both the Foothills Water Company (which had been renamed as the Cañada Hills Water Company) and the Rancho Vistoso Water Company in 1996.

On November 5, 2001, Mayor and Council approved an Intergovernmental Agreement (IGA) under which Tucson and Oro Valley resolved outstanding water issues. The IGA represented the conclusion of negotiations over the last several years and deals primarily with four areas: (1) resolution of the Northwest Area Agreement litigation, including a transfer of CAP water entitlement from the City to Oro Valley (4,454 acre-feet); (2) control of effluent derived from Oro Valley water service; (3) cooperation in delivery of reclaimed water to non-potable water users in Oro Valley; and (4) cooperation in provision of additional potable water supplies to Oro Valley.

Under the settlement agreement, Oro Valley will remit to Tucson Water, over a ten-year period, approximately \$5,410 plus interest at 6.5% (\$3,750 as settlement of the 1979 Northwest Area Agreement and \$1,660 in reimbursement of

capital charges associated with the CAP entitlement to be transferred to Oro Valley). The agreement becomes null and void if the Central Arizona Water Conservation District and the United States do not approve the transfer of CAP allocation within two years. The settlement amount of \$5,410 has been reported as operating revenue on the *Statement of Revenues, Expenses, and Changes in Net Assets*.

### **Loans to Tucson Unified School District**

The Utility has entered into two loan agreements with the Tucson Unified School District (TUSD) to provide funds for the conversion of a high school's irrigation system from potable to reclaimed use. Under terms of the first agreement, TUSD continues to pay the higher potable water rate for its reclaimed usage. The billing difference (actual potable billing minus theoretical reclaimed billing), less interest at 8%, will be applied monthly to the loan balance. The loan balance of \$100 is anticipated to be repaid by June 2011. Under terms of the second agreement TUSD pays the standard reclaimed usage rate, repaying the loan, with interest at 5%, over a five-year period. The loan balance of \$88 will be repaid by November 2006.



*Heavy equipment mechanics are part of the extensive Operations and Maintenance Division which services all of Tucson Water.*



## NOTES TO FINANCIAL STATEMENTS

### 6. RESTRICTED ASSETS AND LIABILITIES PAYABLE FROM RESTRICTED ASSETS

#### a. Restricted Assets

Restricted assets as of June 30, 2002 consist of the following:

<u>Source</u>	<u>Restricted Purpose</u>	
Debt service	Cash/investments held by the City of Tucson restricted for payment of matured revenue bond principal and interest	\$ 14,057
Unspent revenue bond proceeds/loan proceeds receivable	Cash/investments held by the City of Tucson/ accrued interest receivable/ other receivables restricted for authorized bond funded capital improvement projects	31,068
Construction project vendor deposited investments	Construction vendor investments (deposited in lieu of Utility retainage on construction payments) restricted for reimbursement to vendor	54
	Total restricted assets	<u>\$ 45,179</u>



*An operator at the reclaimed facilities, closely monitors operations at the Reclaimed Water Treatment Plant.*

**NOTES TO FINANCIAL STATEMENTS****b. Liabilities Payable from Restricted Assets**

Liabilities payable from restricted assets as of June 30, 2002 consist of the following:

<u>Source</u>	<u>Restricted Purpose</u>	
Debt service restricted assets	Matured bonds and interest payable	\$ 13,959
Unspent revenue bond/loan proceed assets	Accounts payable on authorized bond funded capital improvement projects/ due to other funds pending loan reimbursement	4,890
Construction project vendor deposited	Accounts payable, investments returnable to vendors (deposited in lieu of Utility retainage on construction payments)	54
Total liabilities payable from restricted assets		<u>\$ 18,903</u>



*Tucson Water staff enthusiastically take part in the new Maintenance Management Program designed to streamline and update operations.*

## NOTES TO FINANCIAL STATEMENTS

### 7. CAPITAL ASSETS

The following is a summary of the changes in Capital Assets:

	<i>Beginning Balance</i>	<i>Additions/ Transfers<sup>(1)</sup></i>	<i>Reductions/ Transfers</i>	<i>Ending Balance</i>
Land	\$ 46,387	\$ 1,825	\$ (3,067)	\$ 45,145
Buildings	100,675	1,449	(32)	102,092
Transmission and Distribution Systems	549,308	230,583	(197,699)	582,192
Wells, Tanks, and Reservoirs	183,102	28,463	(11,982)	199,583
Equipment	16,727	4,510	(1,632)	19,605
Construction in Progress	106,657	39,141	(49,948)	95,850
Total at Historical Cost	1,002,856	305,971	(264,360)	1,044,467
Less Accumulated Depreciation for:				
Buildings	16,232	4,415	(24)	20,623
Transmission and Distribution Systems	139,204	12,585	(2,323)	149,466
Wells, Tanks, and Reservoirs	31,696	5,434	(696)	36,434
Equipment	9,344	1,523	(276)	10,591
Total Accumulated Depreciation	196,476	23,957	(3,319)	217,114
Net Capital Assets	\$ 806,380	\$282,014	\$(261,041)	\$827,353

<sup>(1)</sup> Capital asset additions are reported here on an accrual basis.

### 8. CHANGES IN LONG-TERM DEBT

A summary of changes in long-term debt as of June 30, 2002 is as follows:

	<i>Beginning Balance</i>	<i>Additions/ Refunded Issues</i>	<i>Reductions/ Refunded Issues</i>	<i>Ending Balance</i>	<i>Due Within One Year</i>
Water Revenue Bonds Payable	\$278,562	\$121,862	\$ -65,425	\$334,999	\$8,102
Deferred Amounts:					
On Premiums		-7,475	288	-7,187	
On Refundings		4,668	-77	4,591	
Total Water Revenue Bonds Payable	278,562	119,055	-65,214	332,403	8,102
Compensated Absences	1,331	1,864	-52	3,143	1,716
Contracts Payable	43	1,450	-304	1,189	339
Arbitrage Rebate Payable	111		-1	110	
Total Long Term Debt	\$280,047	\$122,369	\$ -65,571	\$336,845	\$10,157

**NOTES TO FINANCIAL STATEMENTS****9. REVENUE BONDS PAYABLE**

Water revenue bonds, secured by water sales revenues, to be sold by the Utility require approval of a majority of City of Tucson voters at a bond election. At the most recent bond election, held May 16, 2000, voters approved an additional \$123.6 million water revenue bond authorization.

At June 30, 2002, the long-term portion of bonds payable was:

Bonds maturing 2002 – 2024	\$	334,999
Less current installments		(8,102)
Deferred amount on refunding *		(2,596)
Total long-term revenue bonds payable	\$	<u>324,301</u>

\* Losses on refundings are amortized over the shorter of (1) the period remaining on refunded bonds, or (2) the repayment period of refunding bonds. Amortization during the years ended June 30, 2002 and 2001 was \$236 and \$170, respectively.

**Water Utility Revenue Bonds Issued and Outstanding**

<i>Series</i>	<i>Interest Rates</i>	<i>Maturity Date</i>	<i>Original Amount</i>	<i>Balance Outstanding June 30, 2002</i>
1984 Series D (1991)	9.75 %	2010	\$ 48,000	\$ 4,000
1992 April (Refunding)	6.2 - 6.35	2004	13,030	2,500
1992 September (Refunding)	5.5 - 6.0	2018	72,080	480
1993 March (Refunding)	5.25 - 5.50	2018	35,360	34,610
1994 Series A (1996)	6.0 - 8.0	2018	33,000	3,000
1994 Series B (1997)	4.50 - 6.25	2012	11,700	10,000
1997 July (Refunding)	4.20 - 5.125	2021	32,980	32,500
1998A Water Infrastructure Finance Authority (WIFA) Subsidized	3.425	2017	6,000	5,235
1994 Series C (1999)	4.75 - 6.75	2016	33,400	33,300
1999A Refunding	5.00	2010	14,045	13,070
1994 Series D (2000)	5.25 - 7.25	2024	23,740	23,740
2000 Water Infrastructure Finance Authority (WIFA) Subsidized	4.125	2020	5,120	4,937
2000 Water Infrastructure Finance Authority (WIFA) Unsubsidized	5.00	2020	7,780	7,525
2001A April (Refunding)	5.00	2016	40,850	38,240
2001 April (Refunding)	5.0 - 7.5	2023	37,800	37,800
2001 Water Infrastructure Finance Authority (WIFA) Subsidized	3.43	2021	7,342	7,342 <sup>(1)</sup>
2002 Refunding	5.50	2018	57,820	57,820
2000 Series B (2002)	3.5 - 5.125	2021	18,900	18,900
Total			<u>\$ 498,947</u>	<u>\$ 334,999</u>

<sup>(1)</sup> Balance of issue (\$1,458) will be recognized when proceeds are received.

## NOTES TO FINANCIAL STATEMENTS

Maturities of the bonds and related interest payable after June 30, 2002 are as follows:

<i>Year ending June 30,</i>	<i>Principal</i>	<i>Interest</i>	<i>Total</i>
2003	\$ 8,102	\$ 17,575	\$ 25,677
2004	8,669	17,059	25,728
2005	9,368	16,605	25,973
2006	9,993	16,109	26,102
2007	11,941	15,573	27,514
2008-2012	78,250	66,824	145,074
2013-2017	99,498	43,530	143,028
2018-2022	92,878	17,909	110,787
2023-2027	16,300	976	17,276
Total	<u>\$ 334,999</u>	<u>\$ 212,160</u>	<u>\$ 547,159</u>

### 10. ADVANCE REFUNDING/DEFEASANCE OF DEBT

On April 3, 2002, the City issued \$57,820 Water Utility Revenue Refunding Bonds to refund a portion of Revenue Bond Series 1992A and to pay costs relating to the issuance of the bonds. The interest rate on the bonds is 5.5% with the final maturity due 7/1/2018. Debt service payments are scheduled semi-annually at amounts that range from \$777-\$12,090. The economic gain resulting from this refunding is \$3,152 (based upon NPV from delivery date). The difference in the cash flow requirements to service the old debt (\$100,285) and the cash flows to service the new debt (\$96,123) was \$4,162.

In prior years, the City has defeased various bond issues by creating irrevocable trusts. The proceeds from the advance refundings have been deposited in these trusts and invested in U.S. Governmental Securities that are designed to meet the requirements of the refunded debt. The debt associated with the refunding issues, as well as the trust assets, has been removed from the City's basic financial statements. As of June 30, 2002, the amount of defeased debt outstanding, but removed, is \$142,765.

### 11. LONG-TERM CONTRACT PAYABLE

Long-term contract payable as of June 30, 2002 consisted of contracts relating to the acquisition of the Metropolitan and K&V water companies:

Purchase of water companies	\$ 1,189
Less current installments	<u>(339)</u>
Total long-term contract payable	<u>\$ 850</u>

The Metropolitan and K&V water company contracts bear interest at 7.0% and 5.5% and mature in January 2005 and January 2003, respectively.

The Utility purchased the Metropolitan Water Company, an Arizona limited partnership, on October 1, 1992 for \$14,176. A down payment of \$5,176 was made and a 13-year note at 7% annual interest was

**NOTES TO FINANCIAL STATEMENTS**

executed for the \$9,000 balance. Also on October 1, 1992, the Utility sold these assets and miscellaneous improvements to the Metropolitan Water Improvement District and the Oro Valley Domestic Water Improvement District for \$14,497 in cash. Adequate sales proceeds were invested in U.S. Treasury Strips with maturities scheduled to meet all future payment obligations by the Utility to the previous owners of the Metropolitan Water Company. These investments are reported as long-term assets of the Utility – *Investments for Contract Payments* (\$1,307 as of June 30, 2002). As of June 30, 2002, principal payments of \$7,700 have been made on the note.

The final principal payment on the K&V contract is due January 2003. The remaining principal on both contracts is payable as follows:

January 1, 2003	\$ 339
January 1, 2004	450
Later years	400
Total principal payable at June 30, 2002	<u>\$ 1,189</u>

**12. OTHER LONG-TERM LIABILITIES**

Other long-term Liabilities are made up of accrued compensated absences and arbitrage rebates on Water Revenue bonds as follows:

**a. Accrued compensated absences**

The costs of employee vacation leave, sick leave, accumulated compensatory time, and any salary-related amounts are expensed as earned. Accrued compensated absences not expected to be utilized by employees within the next year are recorded as long-term liabilities. The long-term liability related to accrued compensated absences was \$1,427 at June 30, 2002.

**b. Arbitrage tax liability**

The arbitrage tax liability results when interest earnings on water revenue bond proceeds exceed the related water revenue bond's yield. The Utility's liability balance at June 30, 2002 of \$110 is equal to the excess earnings and includes no penalties; penalties accrue only if payment to the IRS does not meet scheduled payment dates.

The Utility's next required rebate date is July 1, 2005. Total other long-term liabilities as of June 30, 2002 were:

Accrued compensated absences	\$ 1,427
Arbitrage tax liability	110
Total other long-term liabilities payable	<u>\$ 1,537</u>

**13. DEVELOPER CONTRIBUTIONS**

Developers of land within the Utility's service area are required to install water distribution systems meeting the Utility's standards. Once completed and inspected by Utility staff, the developer donates the systems to the Utility. During the year ended June 30, 2002, developers donated water systems valued at \$9,972.



**NOTES TO FINANCIAL STATEMENTS****14. INSURANCE**

The Utility is exposed to various risks of losses related to tort: theft of, damage to, and destruction of assets; errors and omissions; injuries to employees; and natural disasters. Coverage is obtained through participation in the City's self-insurance program. The Utility pays a premium, calculated annually based on its claims history, to the City's Self-Insurance Fund. During FY 2002, the Utility premium was \$1,271. All risk management activities are accounted for in this City Fund.

The City has obtained commercial coverage for Property Insurance, Public Employee Fidelity Bonds, Crime Insurance, Aircraft Insurance and Miscellaneous Insurance (surety bonds, special event insurance as needed and fine arts coverage).

During the last three years, all City settlements have been less than the insurance coverage provided by this fund. The City retains all of the risk not covered by commercial carriers and manages risk through various employee education and prevention programs.



*One of the basins in Avra Valley used to recharge Colorado River water.*

**15. PENSION PLAN/DEFERRED COMPENSATION PLANS/POST RETIREMENT BENEFITS**

Utility employees are employees of the City of Tucson and eligible to participate in its pension, deferred compensation, and post-retirement benefit plans.

**a. Pension Plan**

Utility employees participate in the Tucson Supplemental Retirement System (TSRS), a single-employer defined benefit plan. Currently, employee contributions are 5% of their annual covered payroll and are made through payroll deductions. A reserve is established for contributions and earnings allocations, less amounts transferred to reserves for retirement and disability and amounts reserved for terminated employees. If an employee leaves covered employment before attaining five years' service credit (eight years' service credit if the member dies), the accumulated contributions plus interest are refunded to the employee or his designated beneficiary. The City contributes the remaining amounts necessary to finance employee participation in the System and to fund the costs of administering the System. Tucson Water's contribution rate for years ended June 30, 2002, 2001, and 2000 was 7.35% or \$1,661, \$1,620, and \$1,573 respectively.

The TSRS issues an annual report that includes financial statements and required supplementary information. The financial statements may be obtained from their administrative office located at 255 W. Alameda Street, Tucson, AZ 85701.

**b. Deferred Compensation**

Utility employees may participate in several deferred compensation plans offered by the City, including both externally managed plans and a plan administered by the City. These plans permit employees to defer a portion of their salaries until future years.

**c. Post Retirement Benefits**

The City subsidizes a health insurance benefit to Utility employees who have qualified to receive a monthly retirement allowance from the Tucson Supplemental Retirement System and are less than 65 years of age. The City pays 75% of the medical insurance premiums for eligible retirees and their dependents. The costs associated with this retirement benefit are expended as the appropriate medical insurance premiums are paid. During the year ended June 30, 2002, the Utility's portion of retiree medical insurance premiums was \$101.

**NOTES TO FINANCIAL STATEMENTS****16. CONTINGENCIES AND COMMITMENTS****a. Operating Leases**

The Utility has entered into operating leases with terms in excess of one year which are not material when taken either individually or collectively and therefore are not disclosed in these notes. All the operating leases are cancelable. The Utility's total rent expense, resulting predominately from as needed rental of heavy equipment to support maintenance functions, was \$434 for the year ended June 30, 2002.

**b. Litigation**

The Utility is contingently liable with respect to lawsuits and other claims incidental to the ordinary course of its operations. At June 30, 2002, it is the opinion of management, based on the advice of the City Attorney, that any pending litigation would not have a material adverse effect on the Utility's financial condition or results of operations.

**c. Construction Retainage and Other Commitments**

The Utility enters in to numerous capital improvement project contracts. Retainage on construction contracts for contract work completed as of June 30 are appropriately identified as accounts payable. Future commitments under project contracts totaled \$30.6 million as of June 30, 2002.

**d. Central Arizona Project Contractual Obligation**

The Utility has a contractual obligation for the purchase of CAP water from the Central Arizona Water Conservation District, the entity responsible for contracting with the Secretary of Interior for CAP water and resulting subcontracting with users within the State of Arizona. The Utility's obligation consists of two components: (1) a capital financing charge based upon the Utility's current allotment of 134,466 acre-feet, and (2) a commodity charge based upon actual CAP water taken.

During fiscal year 2002, the Utility made capital and commodity payments of \$5,985 and \$1,688,

respectively. Estimated CAP water expenses for the next five years are as follows:

<i>Fiscal Year</i>	<i>CAP Capital*</i>	<i>CAP Commodity</i>
2003	\$ 6,176	\$ 2,563
2004	6,176	4,192
2005	6,199	4,320
2006	6,199	4,440
2007	6,199	4,560

*\*Includes capital cost impacts associated with obtaining an additional 1,500 acre-foot allocation in fiscal year 2003 via acquisition of a water company and obtaining an additional 8,206 acre-feet of CAP allocation in fiscal year 2005 as part of a statewide distribution of unallocated CAP water.*

**e. Membership in Central Arizona Groundwater Replenishment District**

The Utility entered into a membership agreement with the CAGRDR during December 1996 to ensure meeting the December 31, 1996 deadline for early application for the State of Arizona's Assured Water Supply (AWS) designation. By meeting the early filing deadline, the Utility was permitted to pump groundwater during 1998, 1999, and 2000 (about 300,000 acre-feet) without being subject to the groundwater pumping limitations in the AWS rules.



*Groundwater flow models show young customers how the aquifer stores and filters our water.*

**NOTES TO FINANCIAL STATEMENTS**

Under terms of the agreement, the Utility is committed to pay an annual replenishment tax for water recharged on the Utility's behalf. Annual payments begin in October 2002 and continue for the following five years. The per-acre-foot tax will consist of the current capital and commodity charges for CAP water, as established annually by CAWCD, plus an administrative fee, a CAGRDR capital facility fee, and a CAGRDR recharge facility operational fee. The tax will be multiplied by the acre-feet of water recharged by the CAGRDR on behalf of the Utility during the prior calendar year, but in no case will it be less than 5,000 acre-feet annually during the six-year membership period.

**f. Water Quality Regulations**

The EPA continues to evaluate studies that will result in a new standard for radon in drinking water. Until the new standard is set, the Utility cannot estimate associated treatment costs.

**17. SUBSEQUENT EVENTS****a. Water Infrastructure Finance Authority Loan**

During September 2002, The City of Tucson Mayor and Council approved entering into a new loan agreement with the Water Infrastructure Finance Authority of Arizona. The loan has semi-annual payments due January 1 and July 1, beginning July 1, 2003. The loan of \$8,300, at a subsidized interest and fee rate of 3.75%, is issued against the 2000 voter authorization of Water revenue bond capacity.

**b. Water Rate Increase**

On September 9, 2002, City of Tucson's Mayor and Council approved a rate increase applicable to potable and reclaimed customers. The 4.3% rate increase became effective October 14, 2002 and is projected to increase water sales revenue by \$2,509 (unaudited) in fiscal year 2003 and by \$4,300 (unaudited) in fiscal year 2004, when the increased rates will be in effect for the entire year.



*An average of 900 samples are taken monthly from monitoring points throughout the Tucson Water distribution system.*



## SCHEDULE I

### Supplemental Schedule of Net Revenue Available for Debt Service (1)

## Revenues:

Sale of water		
Potable water sales		\$ 91,916
Reclaimed water sales		5,567
Central Arizona Project Surcharge		963
Connection fees		3,151
Billing services -		
Pima County Sewer, City of Tucson Solid Waste		1,419
Proceeds - Settlement with Oro Valley		5,410
Miscellaneous revenue		
Area development fees	1,488	
Service Charges	1,356	
TCE clean-up reimbursement	667	
Reimbursed prior year expenses	695	
Other	162	
Total miscellaneous		4,368
Investment earnings – Operating Fund		1,229
Investment earnings – Debt Service Fund		144
Proceeds on sale of property/equipment		114
Total revenues		<u>114,281</u>

## Operation and maintenance expenses:

Director's office		4,022
Business services		8,760
Water operations		16,430
Planning and engineering		5,624
Water quality management		5,836
Power – potable system	10,670	
Power – reclaimed system	938	
Total Power		11,608
CAP water purchases		
Capital charges	5,985	
Commodity	1,688	
Total CAP water purchases		7,673
General expenses		886
Capitalized operation and maintenance expenses		(4,464)
Discount given for early payment (long-term receivable)		920
Total operating and maintenance expenses		<u>57,295</u>
Net revenue available after operations (2)		<u>56,986</u>

## Debt Service for revenue bonds:

Interest on long-term debt		15,786
Principal payments on long-term debt		7,501
Fiscal fees		222
Total Debt Service for revenue bonds		<u>23,509</u>
Net revenue available after operations and water revenue bond debt service		<u>\$ 33,477</u>

(1) This is a special purpose financial statement intended to show compliance with Ordinance 6347.

It is not prepared in accordance with accounting principles generally accepted in the United States of America.

(2) Section 5.02(b) of Ordinance 6347 covenants that the Utility will issue additional bonds only if the previous year's net revenue available after operations equaled or exceeded 120% of the maximum future annual debt service requirement. For the year ended June 30, 2002, the debt coverage on Maximim Future Debt Service was 206%.

An amendment to Section 7.01 of Ordinance 6347 covenants that should Net Revenues of any fiscal year fail to equal or exceed 175% of the year's Annual Debt Service Requirement, the Utility will deposit monies into a reserve account. For the period ended June 30, 2002, the debt coverage for the Annual Debt Service requirement was 242%.

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## SCHEDULE II

### Supplemental Schedule of Flow of Funds

The following *Flow of Funds* schedule reports fiscal year 2002 results commensurate with the methodology Tucson Water uses in establishing water rates; a methodology approved by the American Water Works Association.

Tucson Water, operating as a self-supporting utility of the City of Tucson, must receive sufficient revenues to support operating and capital improvements needs and meet financial policies governing cash reserve balances and debt service coverage (see *Notes to Financial Statements*). The revenues or other available cash sources of the Utility must cover the following each fiscal year:

- *Operations and maintenance expenses:* salaries and wages, fringe benefits, purchased power, payments for Colorado River water, commodities, and taxes.
- *Debt service on water revenue bonds:* principal and interest on water revenue bonds issued by the Utility.
- *Support of system infrastructure development (capital outlay):* Standard financing practices of the water utility industry call for both current ratepayers and future ratepayers to contribute to system infrastructure needs. Thus, the annual capital improvement program is financed by a combination of revenues and bond proceeds. In addition, Tucson Water revenue bond covenants and Mayor and Council Water Policies require that a portion of the Utility's system improvements and equipment needs be provided from revenues rather than bond proceeds. The capital outlay shown in the following *Flow of Funds* schedule reflects only the revenue-funded portion of the fiscal year 2002 outlay.
- *Other uses:* other uses of revenues including (1) payment to the City of Tucson's General Fund for support services provided to the Utility , (2) payment of principal and interest on long-term debt resulting from purchased water companies, (3) funding of loan programs, and (4) increasing Utility working capital.

Schedule II shows the balancing of cash sources and uses for fiscal year 2002.

## SCHEDULE II

### Supplemental Schedule of Flow of Funds (1)

## Revenues for operations and debt service:

Sale of potable water	\$ 91,916	
Sale of reclaimed water	<u>5,567</u>	
Total sale of water		97,483
Central Arizona Project surcharge (2)		963
Connection fees		3,151

## Taxes:

Business privilege tax (State / City)	7,397	
Utility tax (City)	<u>1,304</u>	
Total taxes		8,701

## Interest earnings:

Operating fund interest earnings	1,229	
Debt service fund interest earnings	144	
Less restricted earnings	<u>(113)</u>	
Total interest earnings available for operations and debt service		1,260

## Billing services:

Pima County Sewer, City of Tucson Solid Waste		1,419
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## Miscellaneous revenue:

TCE cleanup reimbursement	667	
Area development fees	1,488	
Service charges	1,356	
Reimbursed prior year expenses	695	
Other	<u>162</u>	
Total miscellaneous revenue		4,368

## Other receipts:

Proceeds from sale of property and equipment	114	
Principal received from litigation settlement (3)	77	
Principal received on loans to school district	<u>21</u>	
Total other receipts		<u>212</u>
Total revenues for operations and debt service		<u>117,557</u>

## Other sources:

Use of Metropolitan Water Company Reserve Account (4)	236	
CAP Reserve Fund interest earnings	<u>11</u>	
Total other sources		<u>247</u>
Total revenues and other sources		<u>\$ 117,804</u>

(1) This schedule presents a flow of funds under the methodology utilized by the Utility in determining needs for revenue adjustments. This statement, based on actual results, enables the Utility to compare results with those projections.

(2) CAP Reserve Fund revenues and interest were generated by a \$.02/Ccf charge applied to potable water sales. Surcharge revenues are designated for payments of CAP water commodity or capital charges. Related interest earnings are designated for capital projects utilizing Colorado River water.

(3) Principal payments from settlement agreement included on this statement the year in which received.  
See Notes to Financial Statements, #6(b).

(4) See Notes to the Financial Statements, #10.



**SCHEDULE II (CONTINUED)**  
**Supplemental Schedule of Flow of Funds (1)**

## Operations and maintenance expense: (5)

Director's office		\$	4,022
Business services			8,760
Water operations (excluding power)			16,430
Planning and engineering (including waterline relocation)			5,624
Water quality management (excluding CAP water purchases/power)			5,836
CAP water: Capital charges	5,985		
Commodity	1,688		
Total CAP water			7,673
Power: Potable system	10,670		
Reclaimed system	938		
Total power			11,608
General expense (including sales taxes of \$8,701)			9,587
Capitalized operations and maintenance expense			(4,464)
Total operations and maintenance expense			65,076
Adjustment for accrued compensated absences (6)			(96)
Adjusted total operations and maintenance expense			64,980

## Debt service on water revenue bonds:

Interest	15,786		
Principal	7,501		
Fiscal fees	222		
Total debt service on water revenue bonds			23,509

## Capital outlay:

Improvements/Equipment from revenues and other sources	13,399		
Capitalized operations and maintenance expense	4,464		
Improvements funded by Central Arizona Project Reserve Fund	10		
Total capital outlay			17,873

## Other uses:

Private water company contract payments	310		
Administrative service charges	6,753		
Reclaimed loans and other uses	105		
Increase in working capital	4,274		
Total other uses			11,442
Total expenses, debt service, capital outlay and other uses		\$	117,804

(5) Capitalized operations and maintenance expense reported separately on this statement.  
It is allocated to Utility Divisions on the Statement of Operations.

(6) Change in year-end long-term compensated absences payable is not included in this statement.

**SCHEDULE III**  
**Supplemental Schedule of Ratio of Outstanding Water Revenue Bonds**  
**to Fixed Assets**  
**(\$ in millions)**

	<i>June 30,</i>					
	<i>1997</i>	<i>1998</i>	<i>1999</i>	<i>2000</i>	<i>2001</i>	<i>2002</i>
Land	\$41.4	\$43.1	\$44.6	\$46.9	\$46.4	\$45.1
Buildings	95.7	96.3	97.3	97.3	100.7	102.1
Water Mains	408.5	442.5	467.0	528.2	549.3	582.2 <sup>(1)</sup>
Reservoirs	114.0	127.3	132.5	142.1	183.1	199.6
Construction in Progress	117.6	109.3	127.2	108.3	106.7	95.9
Machinery	11.9	15.6	17.1	15.2 <sup>(2)</sup>	16.7	19.6
Less Accumulated Depreciation	(143.8)	(156.9)	(169.6)	(143.8)	(196.5)	(217.1) <sup>(3)</sup>
Total Fixed Assets	\$645.3	\$677.2	\$716.1	\$645.3	\$806.4	\$827.4
Water Revenue Bonds Outstanding	\$223.9	\$216.7	\$250.0	\$223.9	\$273.9	\$335.0
Ratio Water Revenue Bonds/Fixed Assets	0.35	0.35	0.35	0.35	0.34	0.40 <sup>(4)</sup>

(1) \$3.9 million in mains, replaced or abandoned in prior years, were written off during FY 2002.

(2) \$2 million of machinery assets were written off in FY 2000 due to a change in capitalization threshold.

(3) During FY 2002, a change in depreciation method resulted in a \$3.7 million increase to accumulated depreciation.  
In addition, \$3.9 million in assets were written off.

(4) Bonds outstanding includes \$18.9 million issued June 27, 2002 for which no capital outlay has occurred as of June 30, 2002. The ratio is .38 if the debt associated with this bond issuance is removed.

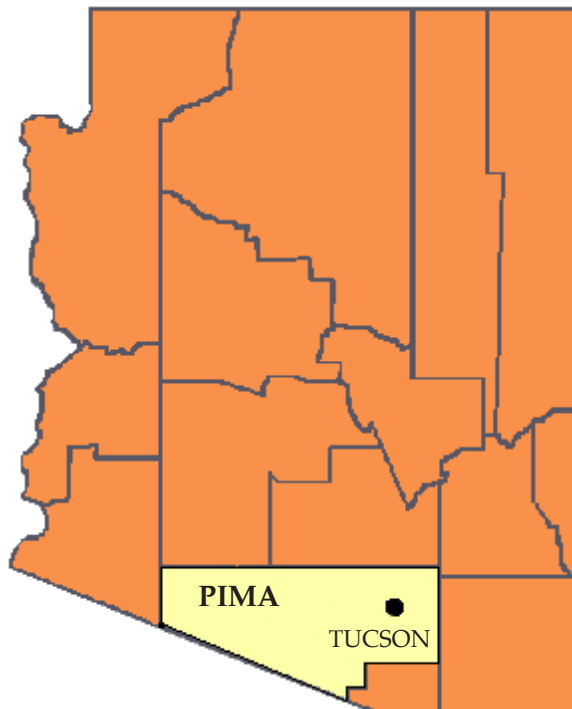
## Tucson Water's Mission

Our commitment is to ensure that our customers  
receive high quality water and excellent service  
in a cost efficient, safe, and environmentally responsible manner.



## Tucson Water's Vision

In partnership with our community,  
we provide excellence in water services  
to secure the future and enhance  
our quality of life.



Tucson, the county seat for Pima County, is the second largest city in Arizona, and has a population of more than 491,000. Incorporated in 1877, the City of Tucson began as a 2 square mile village located in what is now Tucson's central downtown. It has now grown to approximately 225 square miles and lies within a greater metropolitan region of approximately 412 square miles, with a population of approximately 822,000.

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